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No. 641

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

THE CHASE MANHATTAN BANK,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Petitioner, The Chase Manhattan Bank, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above entitled case on August 19, 1958.

CITATIONS TO OPINIONS BELOW

The opinion of the Tax Court (R. 137-158), printed in Appendix B hereto, *infra* p. 25, is reported in 25 T.C. 617. The opinion of the Court of Appeals (R. 213-274), printed in Appendix B hereto, *infra* p. 45, is reported at 259 F. 2d 231. A petition for rehearing was denied by the Court of Appeals without opinion (R. 294).

JURISDICTION

The judgment of the Court of Appeals was entered August 19, 1958 (R. 275; *infra* p. 103). Rehearing was denied

on October 23, 1958 (R. 294). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Whether, in a community property state, a gift tax imposed upon a widow should be measured by one-half of the proceeds of a life insurance policy on her deceased husband, or by one-half of the cash surrender value of the policy where:

(a) All premiums on the policy were paid with community funds, thereby making the wife owner of one-half of the policy.

(b) The policy designated as sole beneficiary a trust created by the insured and his wife; and the trust provided that (1) trust income be paid to the wife during her lifetime, and (2) the remainder be paid to their children.

(c) The trust became irrevocable upon the death of the insured husband.

2. In an inter vivos trust (involving principally stocks and bonds), as well as in the insurance trust referred to in the first question, the question presented is whether: For gift tax purposes, the taxable value of the wife's gift (her one-half interest in the community property transferred to the trusts) should be reduced by the value of all, or one-half, of the life estate in such community property, where:

(a) The deceased husband and the wife, as settlors, created trusts which the husband, as agent of the community estate, could revoke during his lifetime.

(b) The trust instruments each provided that the surviving wife should have all of the trust income during her lifetime, with remainder to their children.

(c) All gifts to the trusts were community property, thereby making the wife owner of one-half of such property at the time the gifts were made.

(d) The trusts each became irrevocable upon the death of the husband.

STATUTES INVOLVED.

The statutory provisions involved are §§311, 827(b), 900, 1000, 1002, 1005, and 1025, Internal Revenue Code of 1939, 53 Stat. 1, 26 U.S.C. §§311, 827(b), 900, 1000, 1002, 1005, and 1025. They are printed in Appendix A, *infra*, p. 17.

STATEMENT

Daniel James Moran and Marie Elizabeth Moran were married prior to 1922 and remained husband and wife until Daniel's death on April 3, 1948 (R. 70). They resided at all material times in Houston, Texas (R. 70). At no time from 1922 to the date of his death did Daniel have any separate property (R. 72).

On or about November 2, 1928, Daniel, as manager of community, created an inter vivos trust out of community property with a predecessor to taxpayer bank as trustee (R. 69). Taxpayer later became the trustee (R. 69-70). Income was payable first to Daniel for life, then to Marie for life, with remainder to their descendants (R. 85). Daniel, as manager of the community, reserved the right to alter, amend, or revoke the trust (R. 88).

On the same day Daniel, as manager of the community, created an insurance trust with the same trustee (R. 68). Trust corpus consisted of various insurance policies on the life of Daniel (R. 69, 73). Daniel, as manager of the community, reserved the right to alter, amend, or revoke the trust and to change the beneficiaries of the insurance (R. 76). Premiums were paid out of community property (R.

141). Upon Daniel's death the income was to go to Marie for life, and, when she died, the principal was to go to their descendants (R. 73). Following Daniel's death on April 3, 1948, the proceeds of the insurance policies in the insurance trust were paid to the trustee, and all of the income from this trust has subsequently been paid to Marie (R. 69, 72).

Daniel's will, which was duly admitted to probate, provided for a trust with the taxpayer bank as trustee (R. 70-71). Under the terms of this trust Marie received a life estate and the remainder was to go at her death to the descendants of Daniel and Marie then surviving (R. 95-98). No complaint is made of the decision of the Court of Appeals with respect to Daniel's will or the testamentary trust which it created, so neither his will nor the testamentary trust will be discussed further herein.

The Commissioner of Internal Revenue claimed that on April 3, 1948, the date of Daniel's death, the insurance trust and the inter vivos trust became irrevocable and that as of such date Marie made gifts to the remaindermen of her community one-half interest in the corpus of each such trust less her life estate in such one-half (R. 142-143).

The resulting deficiency was determined against taxpayer as trustee and transferee (R. 143). No part thereof has ever been assessed against Marie, nor was any attempt made to collect any part of it from her (R. 143). The determination of a deficiency against taxpayer was first made after expiration of the time within which a gift tax deficiency could have been determined against Marie (R. 143).

The Tax Court held that taxpayer was accountable as transferee. It also held that there was no tax at all as to the insurance trust; and that as to the inter vivos trust there was a gift measured by the difference between the value of Marie's one-half interest in the corpus, less the value of her life estate in the entire corpus.

The Court of Appeals reversed the Tax Court's decision with respect to both the inter vivos trust and the insurance trust. Concerning the inter vivos trust the Court of Appeals held that, by acquiescing in the trust, Marie made a gift of her one-half community property interest but that, in determining the amount of the gift, taxpayer could deduct only the value of the life estate reserved from her one-half community interest. In valuing the gift, taxpayer was not permitted to deduct the value of Marie's life estate reserved from Daniel's half of the community estate. With respect to the insurance trust the Court of Appeals held that a completed gift had been made by Marie at the time of Daniel's death, and it was held that such gift would be equal to one-half of the insurance proceeds, reduced only by the value of Marie's life estate in the one-half community property interest transferred by her. Here also in valuing the gift the Court of Appeals held that taxpayer should not be permitted to deduct the value of Marie's life estate in the insurance trust reserved from Daniel's half of the community estate.

REASONS FOR GRANTING THE WRIT

1. The decision of the Court of Appeals concerning the insurance trust is in direct conflict with an applicable decision of this Court.

This Honorable Court recently held in *United States v. Bess*, 357 U.S. 51, that for federal income tax purposes a beneficiary of a life insurance policy is a transferee at most of the cash surrender value and not of the proceeds of the policy. In the *Bess* case, the United States had perfected its tax lien against Mr. Bess for the nonpayment of his 1945 and 1946 income taxes. Before such taxes were collected, Mr. Bess died. Proceeds of insurance on the life of Mr.

Bess were paid to his widow. Under the applicable state and federal law the tax collector could collect the income tax deficiency owed by Mr. Bess from his widow *to the extent that there was a TRANSFER of property without consideration from the insured to Mrs. Bess.* It was necessary, therefore, for this Court to meet head-on the question of whether any property was transferred from Mr. Bess to his widow under the terms of the insurance policies on his life. On this point this Honorable Court held at p. 55 of 357 U.S.:

> *"Third.* We must now decide whether Mr. Bess possessed in his lifetime, within the meaning of §3670, any 'property' or 'rights to property' in the insurance policies to which the perfected lien for the 1946 taxes might attach. Since §3670 creates no property rights but merely attaches consequences, federally defined, to rights created under state law, *Fidelity & Deposit Co.* v. *New York City Housing Authority*, 241 F. 2d 142, 144, we must look first to Mr. Bess' right in the policies as defined by state law.
>
> "(a) It is not questioned that the rights of the insured are measured by the policy contract as enforced by New Jersey law. Manifestly the insured could not enjoy the possession of the proceeds in his lifetime. His right to change the beneficiary, even to designate his estate to receive the proceeds, gives him no right to receive the proceeds while he lives. Cf. *Rowen* v. *Commissioner*, 215 F. 2d 641, 644. It would be anomalous to view as 'property' subject to lien proceeds never within the insured's reach to enjoy, and which are reducible to possession by another only upon the insured's death when his right to change the beneficiary comes to an end. We therefore do not believe that Mr. Bess had 'property' or 'rights to property' in the proceeds, within the meaning of §3670, to which the federal tax lien might attach. . . . "

At p. 67 of 357 U.S. this Court further held:

"*Fourth.* The transfer of property subsequent to the attachment of the lien does not affect the lien, for it is of the very nature and essence of a lien, that no matter into whose hands the property goes, it passes cum onere . . . ' *Burton* v. *Smith*, 13 Pet. 464, 483; see *Michigan* v. *United States*, 317 U.S. 338, 340. The question therefore is whether the cash surrender values with the lien attached were transferred to Mrs. Bess as beneficiary when Mr. Bess died.

"It is argued that the right to receive the cash surrender value expires with the death of the insured and that thus no property of his passes to the beneficiary. The contention is that the beneficiary receives the proceeds of the policies as performance by the insurance company of a separate promise to pay upon the death of the insured. It is said to follow that 'there is no logical escape from holding that the "surrender value" comes to an end on the insured's death, if we dispose of the controversy in accordance with the ordinary rules governing contracts.' *United States* v. *Behrens*, 230 F. 2d 504, 506-507. This is to say that the cash surrender value is no part of the proceeds, but represents merely the right of the insured to cancel the policy and thereupon receive back from the insurer the amount accumulated from premiums paid in the past and held to cover the risk to be incurred in the future. . . . Therefore it is said that the property represented by the cash surrender value disappears on the insured's death and no lien can survive in any part of the proceeds.

"But the courts have long recognized that the surplus of the paid premiums accumulated to make up the cash surrender value should be treated for some purposes as though in fact a 'fund' held by the insurer for the benefit of the insured. Judge Addison Brown stated in *In re McKinney*, 15 F. 535, 537:

> 'Though this excess of premiums paid is legally the sole property of the company, still in practical effect, though not in law, it is the moneys of the assured deposited with the company in advance to make up the deficiency in later premiums. . . . So long as the policy remains in force the company has not practically any beneficial interest in it, except as its custodian, with the obligation to maintain it unimpaired and suitably invested for the benefit of the insured. This is the practical, though not the legal, relation of the company to this fund.'

This view was approved in *Hiscock* v. *Mertens*, 205 U.S. 202, 211, and *Burlingham* v. *Crouse*, 228 U.S. 459, 469. See also *United States* v. *Behrens, supra*, at 507. Thus in economic reality the insurer pays the beneficiary the insured's 'fund,' plus another amount sufficient to perform the insurer's promise to pay the proceeds on the insured's death. *Rowen* v. *Commissioner, supra*, at 647. Therefore we hold that, for purposes of §3670, there was a transfer of property from the insured to Mrs. Bess, and that the lien attached to the property before his death followed the property into her hands. . . ."

It is clear from reading the decision of this Court in the *Bess* case that no more than an amount equal to the cash surrender value of an insurance policy can be considered as having been transferred from the policy owner to a beneficiary under the policy at the time of the insured's death. In this respect the law of Texas or New York would be no different from the law of New Jersey, to which this Court looked in the *Bess* case. The rule can be no different when ascertaining gift tax liability. The gift tax statute imposes a gift tax *only* on property *transferred* from a donor to a

donee. §1000, I.R.C. 1939.[1] Accordingly, the gift tax liability of Marie Moran may be imposed upon the beneficiaries of the policies on the life of Daniel Moran only to the extent that there was a TRANSFER of property without consideration from Marie Moran to the beneficiaries of the insurance trust (other than herself), and it is clear under the holding of this Court in the *Bess* case that Marie Moran could not transfer more than the cash surrender value of the policies since that is all she ever had.

If Daniel and Marie Moran had irrevocably assigned the policies to a third party prior to Daniel's death, it is believed that even the Government would agree that a gift tax could be imposed upon no more than the cash surrender value of the policies. The rule with respect to the transfer *by Marie* should be no different merely because Daniel had died. There is no statute or other controlling authority imposing a gift tax measured by the proceeds of an insurance policy. The decision of this Court in the *Bess* case is direct and controlling authority that only an amount equal to the cash surrender value of an insurance policy, and not the proceeds, are transferred from the owner of the policy upon the death of the insured.

When we turn to the gift tax *transferee* provisions, we again find absolutely no authority for imposing a gift tax upon a beneficiary of an insurance policy measured by the proceeds of such policy. Here, as in the substantive provisions of the gift tax statute, *the only inference that can be drawn* is that Congress did not impose, and did not intend to impose, a gift tax upon the beneficiary of an insurance policy measured by the proceeds of such policy. There is no substantive or procedural provision in either the gift tax statute or the gift tax transferee statute that can be

[1] Since the Internal Revenue Code of 1939 was applicable to the taxable year involved in the instant case, all section number references in this petition are to the Internal Revenue Code of 1939.

stretched to cause a gift tax to be measured by the proceeds of life insurance. We know of no authoritative court decisions, other than the decision of the Court of Appeals in the instant case, which have even hinted that any provision in the gift tax law should be given such broad and unwarranted construction.

The gift tax transferee statute, §1025, I.R.C., is almost precisely identical to the income tax transferee statute, §311, I.R.C., which was construed by this Court in the *Bess* case. Gift tax transferee liability, like income tax transferee liability, is limited by statute. *The gift tax transferee statute, like the income tax transferee statute, does not provide for transferee liability for life insurance PROCEEDS.* Transferee liability does not extend beyond the express provisions of the statute. If the gift tax transferee liability statute were meant to impose a tax upon life insurance beneficiaries measured by the proceeds they receive from the policies, it would have said so, as the estate tax transferee liability statute says so. See §§827(b) and 900, I.R.C. Since the income tax and the gift tax transferee provisions are virtually identical, and since there is nothing in the gift tax statute imposing a gift tax measured by insurance proceeds upon either a donor or a donee of rights under an insurance policy, the gift tax liability of The Chase Manhattan Bank, as transferee, should be limited to one-half of the cash surrender value of the policies on the life of Daniel, less the value of the life estate possessed by Marie, under the terms of the insurance trust.

2. **The decision of the Court of Appeals in the instant case concerning the inter vivos trust and the insurance trust is in direct conflict with the decision of the Court of Appeals for the Ninth Circuit in Commissioner v. Siegel.**

In *Commissioner* v. *Siegel*, 250 F. 2d 339 (9th Cir.), involving citizens of California, Mr. and Mrs. Siegel, at the time of Mr. Siegel's death, owned considerable property as their community property. Mr. Siegel's will attempted to dispose of both halves of the community property, giving Mrs. Siegel all of the income from both halves of their community estate during her lifetime, with remainder to their children upon her death. Under California law, Mrs. Siegel had the option either to take a life estate in both halves of the community under the will with the remainder (entire community estate) going to the children upon her death, or to reject the will (which provided a life estate in both halves of the community property) and continue as owner of her one-half of the community estate. Confronted with making this election, she chose to take under the will. Thus, she gave up her fee interest in one-half of the community estate and in return received the right to all of the income during her lifetime from both halves of the community. California and Texas law are the same with respect to this doctrine of election.

The Commissioner of Internal Revenue claimed that Mrs. Siegel, by electing to take under Mr. Siegel's will, made a gift to the remaindermen named in the will. It was further claimed that there was a taxable gift to the extent that the value of Mrs. Siegel's fee interest in all the community property exceeded the value of her life estate in only her one-half of the community. Both the Tax Court[2] and the Court of Appeals for the Ninth Circuit,[3] while holding that Mrs. Siegel had made a gift, determined that the amount of such gift would be equal to the value of her one-half of the community estate, less the value of her life estate in both halves of the community. Thus, the measure of her taxable

[2] 26 T.C. 743.
[3] 250 F. 2d 339.

gift was the difference between the fee in one-half of the community property and the life estate in both halves.

This is no different from the case at bar. Indeed, the Tax Court found no distinction between the instant case and the *Siegel* case, since in each such case it held that the taxable gift made by the surviving widow was equal to the value of her one-half of the community estate, less the value of her life income from both halves of the community. The Court of Appeals for the Fifth Circuit, however, disagreeing with both the Tax Court and the Court of Appeals for the Ninth Circuit, held that the taxable gift made by the surviving widow under such facts was equal to the value of her one-half of the community property, less the value of her life estate in only the one-half of the community property transferred by her.

In reaching its decision in the instant case the Court of Appeals for the Fifth Circuit found that the inter vivos trust created by Daniel and Marie Moran was a present, valid trust in 1928. Daniel, *as agent for the community and, therefore, for Marie*, held the right to revoke the trust during his lifetime. When Daniel died, the community estate lost the power of revocation, and the gift was complete. Immediately before Daniel's death, Marie held through her agent (her husband) what amounted to full dominion over a full one-half of the community property. Immediately after Daniel's death, she held a life interest in both halves of the community estate. Any gift by Marie could be no more than the difference between the two.

In the instant case the Court of Appeals held that the inter vivos trust validly existed back in 1928. The court then stated the correct, but technical, conclusion of Texas law that Daniel's control over the trust for the following twenty years until his death in 1948 could be exercised only as *agent for the community*. If this technical conclusion be

true, then it is also true beyond a doubt that an agent acts for his principal, in this case the community composed of Daniel *and* Marie. The logical, necessary extension of this principle would bring the court right back to *Siegel*: Until the time of Daniel's death, Marie, through her agent, had complete power of revocation. She permitted that power to lapse by not exercising it before Daniel's death. Marie permitted this to happen and, by her inaction, came into ownership of a life estate in the whole, where before she owned only a fee in one-half. Marie failed to have her agent revoke the trust, knowing that under the terms of the trust she would have the income for life from the entire trust properties after Daniel's death. When Daniel died, this came to pass. Marie gave up her one-half community property interest in the trust properties. The consideration for the relinquishment of her community property interest was her right to receive the income from the entire trust property during her lifetime. The gift tax statute provides that, if the gift is made in property, only the value thereof at the date of gift shall be considered the amount of the gift. §1005, I.R.C. Another section of the statute very plainly provides that a gift tax is to be imposed only upon the value of property transferred after deducting from it the value of property retained or received by the transferor. §1002, I.R.C. Unless the plain meaning of these statutes is to be ignored, it must be held that the gift made by Marie was her one-half community property interest in the trust properties, less her right to the income from the entire trust properties during her lifetime.

We believe the Tax Court very clearly set forth the proper legal conclusion to be applied in the instant case when it stated at p. 625 of 25 T.C. (R. 152):

"The next issue is the amount of the gift. Respond-

ent contends that the gift consisted of the value of Marie's one-half interest in the principal less the value of a life estate in one-half of the principal. We agree with petitioner, however, that the value of the gift must be reduced by the value of the life estate received by Marie in the entire principal. By failing to assert her community property rights, Marie made a gift of her one-half interest in the principal minus her life estate in the entire principal. The trust which she accepted in lieu of her community property interest in the principal was a single package; there were not two trusts, one based upon the principal representing her one-half and the other upon her husband's one-half; and we know of no basis under Texas law whereby she could have disaffirmed one-half of the trust while at the same time retaining the benefits of the other one-half. Indeed, in the Testamentary Trust, hereinafter considered, the instrument expressly stated that the provision for Marie was to be in lieu of all rights due her as surviving spouse; and what was explicit in that trust was plainly implicit in the Inter Vivos Trust. What she in fact did was to accept the trust which gave her a life estate in the entire principal in exchange for her full interest in one-half of the principal."

If it be determined that only Daniel had the power to revoke the trusts at the time of his death and that he was *not* acting as agent for the community estate, then Marie would have made no gift in 1948. The gift as to her would have been complete in 1928, at the time the gifts to the trusts were completed, since she retained no powers over trust principal or income except through Daniel. If Marie, through Daniel as agent for the community estate, had the power until Daniel's death either (1) to revoke the trusts and claim her one-half community property interest in fee, or (2) to affirm the trusts and accept trust income from both halves of the community estate, then the issue presented in the instant

case is precisely the same as that decided by the Ninth Circuit in the *Siegel* case. If only Daniel had the power to revoke the trusts and if he were not acting as agent for the community in possessing such power, *then the transfers in trusts as to Marie were completed gifts in 1928 and she made no gifts at all with respect to these trusts in 1948.* If it be determined that Marie made any gift in 1948, then the decision of the Court of Appeals for the Fifth Circuit in the instant case is squarely in conflict with the decision of the Court of Appeals for the Ninth Circuit in *Siegel* v. *Commissioner.*

3. This case raises important questions of federal law which should be settled by this Court.

The court below has held that one-half of insurance proceeds should be taxed as a gift from a surviving spouse where an insurance policy is owned by the insured and his surviving spouse as community property and where the policy designates someone other than the surviving spouse as a beneficiary. Every time an insurance policy is owned by an insured and his surviving spouse as community property and the policy designates someone other than the surviving spouse as beneficiary, the question presented in the instant case will arise. Taxpayer does not now question that a gift from the surviving spouse to the beneficiary designated in the policy arises in such a situation, but determination of the amount of the taxable gift in such a situation will cause continuing controversies until the issue is finally decided by this Court. This question will arise with respect to many thousands of taxpayers, so for this reason it is extremely important; in the proper administration of the revenue laws, that the issue presented herein with respect to insurance be determined.

The second issue presented in this case, i.e. that of deter-

mining the amount of taxable gift from a surviving spouse where the surviving spouse receives a life income from both halves of community property transferred for the ultimate benefit of another, is extremely important. It is very common for the surviving spouse to receive income for life from both halves of community property and to pass on the ultimate remainder to the children. Since the remainder to the children becomes vested at the time the transfer (subject to the retained life estate) is made, a determination must be made at that time as to the value of the taxable gift from the surviving spouse. This question, until settled, will arise frequently in all of the community property states. Further, a conflict of decisions on this issue already exists between the Court of Appeals for the Fifth Circuit and the Court of Appeals for the Ninth Circuit. Therefore, to prevent many needless controversies involving this question, it is extremely important that this issue be determined promptly by this Court.

This petition refers to the 1939 Code since the taxable year involved was a year to which that Code was applicable. Nevertheless, the corresponding portions of the 1954 Code are identical to the 1939 Code provisions discussed herein, and the issues presented herein are of continuing importance and will undoubtedly arise repeatedly under present day law.

CONCLUSION

For the foregoing reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

Statutes

Sec. 311. TRANSFERRED ASSETS. [Income Tax]

(a) Method of Collection. — The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) Transferees. — The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this chapter.

(2) Fiduciaries. — The liability of a fiduciary under section 3467 of the Revised Statutes, as amended, (U.S.C., Title 31, § 192) in respect of the payment of any such tax from the estate of the taxpayer.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) Period of Limitation. — The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer, — within one year after the expiration of the period of limitation for assessment against the taxpayer;

(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer, — within one year after the expiration of the period of limitation

for assessment against the preceding transferee, but only if within three years after the expiration of the period of limitation for assessment against the taxpayer; —

except that if before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax or liability in respect thereof has been begun against the taxpayer or last preceding transferee, respectively, — then the period of limitation for assessment of the liability of the transferee shall expire one year after the return of execution in the court proceeding.

(3) In the case of the liability of a fiduciary, — not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later;

(4) Where before the expiration of the time prescribed in paragraph (1), (2), or (3) for the assessment of the liability, both the Commissioner and the transferee or fiduciary have consented in writing to its assessment after such time, the liability may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(c) Period for Assessment against Taxpayer. — For the purposes of this section, if the taxpayer is deceased, or in the case of a corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had death or termination of existence not occurred.

(d) Suspension of Running of Statute of Limitations. — The running of the statute of limitations upon the assess-

ment of the liability of a transferee or fiduciary shall, after the mailing to the transferee or fiduciary of the notice provided for in section 272(a), be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for sixty days thereafter.

(e) Address for Notice of Liability. — In the absence of notice to the Commissioner under section 312(a) of the existence of a fiduciary relationship, notice of liability enforceable under this section in respect of a tax imposed by this chapter, if mailed to the person subject to the liability at his last known address, shall be sufficient for the purposes of this chapter even if such person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(f) Definition of "Transferee." — As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

Sec. 827. LIEN FOR TAX.

* * * *

(b) Liability of Transferee, etc. — If the tax herein imposed is not paid when due, then the spouse, transferee, trustee, surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has, on the date of the decedent's death, property included in the gross estate under section 811 (b), (c), (d), (e), (f), or (g), to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax.

Any part of such property sold by such spouse, transferee, trustee, surviving tenant, person in possession of property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, to a bona fide purchaser for an adequate and full consideration in money or money's worth shall be divested of the lien provided in section 827(a) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, or beneficiary, except any part sold to a bona fide purchaser for an adequate and full consideration in money or money's worth.

* * * *

Sec. 900. TRANSFERRED ASSETS. [Estate Tax]

(a) Method of Collection. — The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this subchapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) Transferees. — The liability, at law or in equity, of a transferee of property of a decedent, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed by this subchapter.

(2) Fiduciaries. — The liability of a fiduciary under section 3467 of the Revised Statutes (U.S.C., Title 31, § 192) in respect of the payment of any such tax from the estate of the decedent.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) Period of Limitation. — The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) Within one year after the expiration of the period of limitation for assessment against the executor.

(2) If a court proceeding against the executor for the collection of the tax has been begun within the period provided in paragraph (1) — then within one year after return of execution in such proceeding.

(c) Suspension of Running of Statute of Limitations. — The running of the statute of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing of the notice under section 871(a) to the transferee or fiduciary, be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter.

(d) Prohibition of Suits to Restrain Enforcement of Liability of Transferee or Fiduciary. — No suit shall be maintained in any court for the purpose of restraining the assessment or collection of (1) the amount of the liability, at law or in equity, of a transferee of property of a taxpayer in respect of any estate tax, or (2) the amount of the liability of a fiduciary under section 3467 of the Revised Statutes (U.S.C., Title 31, §192) in respect of any such tax.

(e) Definition of "Transferee". — As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee, and includes a person who, under section 827(b), is personally liable for any part of the tax.

Sec. 1000. IMPOSITION OF TAX.

(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift. . . .

* * *

Sec. 1002. TRANSFER FOR LESS THAN ADEQUATE AND FULL CONSIDERATION.

Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this chapter, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

Sec. 1005. GIFTS MADE IN PROPERTY.

If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

Sec. 1025. TRANSFERRED ASSETS. [Gift Tax]

(a) Method of Collection. — The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in the tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) Transferees. — The liability, at law or in equity, of a transferee of property of a donor, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed by this chapter.

(2) Fiduciaries. — The liability of a fiduciary under section 3467 of the Revised Statutes (U.S.C., title 31, §192) in respect of the payment of any such tax from the estate of the donor.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) Period of Limitation. — The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) Within one year after the expiration of the period of limitation for assessment against the donor.

(2) If a court proceeding against the donor for the collection of the tax has been begun within the period provided in paragraph (1) — then within one year after return of execution in such proceeding.

(c) Period for Assessment against Donor. — For the purposes of this section, if the donor is deceased, the period of limitation for assessment against the donor shall be the period that would be in effect had the death not occurred.

(d). Supension of Running of Statute of Limitations. — The running of the statute of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing of the notice under section 1012(a) to the transferee or fiduciary, be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and, in any event, if a proceeding in respect of

the liability is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter.

(e) Prohibition of Suits to Restrain Enforcement of Liability of Transferee or Fiduciary. — No suit shall be maintained in any court for the purpose of restraining the assessment or collection of (1) the amount of the liability, at law or in equity, of a transferee of property of a donor in respect of any gift tax, or (2) the amount of the liability of a fiduciary under section 3467 of the Revised Statutes (U.S.C., Title 31, §192) in respect of any such tax.

(f) Definition of "Transferee." — As used in this section the term "transferee" includes donee, heir, legatee, devisee, and distributee.

(g) Address for Notice of Liability. — In the absence of notice to the Commissioner under section 1026(b) of the existence of a fiduciary relationship, notice of liability enforceable under this section in respect of a tax imposed by this chapter, if mailed to the person subject to the liability at his last known address, shall be sufficient for the purposes of this chapter even if such person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

APPENDIX B
Opinions and judgments below

Tax Court Opinion

THE TAX COURT OF THE UNITED STATES

Docket No. 48652

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, Trustee and alleged transferee of Marie Elizabeth Moran,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

(December 22, 1955)
(25 T.C. 617)

Respondent has determined a deficiency in gift taxes against petitioner as transferee of Marie Elizabeth Moran, alleged donor. The principal issues are whether her acquiescence in three separate trusts constituted taxable gifts by her of interests allegedly owned by her in the principal of each trust, and, if so, whether petitioner may properly be proceeded against as transferee. Another issue is whether the value of any gift held to have been made by her should be held to be the value of her one-half community interest less only a life estate retained in that one-half, as contended by respondent, or, as contended by petitioner, the value of the gift should be further reduced by the value of a life estate received by her in the other one-half of the

principal as a result of her election to accept the benefits of the trusts.

FINDINGS OF FACT.

Some of the facts have been stipulated and are so found.

Petitioner Chase National Bank (hereinafter referred to as Chase) is a national banking association with principal office in the city and State of New York. The tax in controversy is a gift tax in the amount of $133,578.88 in respect of gifts allegedly made during the calendar year 1948 by Marie Elizabeth Moran. The deficiency has been determined against petitioner as donee and as transferee.

Daniel James Moran (hereinafter called Daniel) and Marie Elizabeth Moran (hereinafter called Marie) were married prior to 1922 and remained husband and wife until Daniel's death on April 3, 1948. They resided at all times material in Houston, Texas. Marie's gift tax return for the calendar year 1948 was filed with the collector of internal revenue for the first district of Texas. At no time from 1922 to the date of his death did Daniel have any separate property.

On or about November 2, 1928, Daniel and the Equitable Trust Company of New York (hereinafter called Equitable) executed an agreement creating a trust (hereinafter called the Inter Vivos Trust). Principal consisted of various securities. Income was payable first to Daniel for life, then to Marie for life, with subsequent distribution governed by provisions not relevant to this proceeding. Daniel reserved the right to alter, amend, or revoke the trust. The instrument provided that its validity and effect should be governed by the laws of the State of New York.

On the same day Daniel and Equitable executed an agreement creating a second trust (hereinafter called the Insurance Trust). Principal consisted of various insurance poli-

cies on the life of Daniel. Daniel reserved the power to alter, amend, or revoke the trust, and to deal with the policies in virtually any manner he might have done had no trust been created. Nothing was to be payable to the trustee under any policy until and in consequence of Daniel's death. Daniel reserved the right to all payments of any kind to be made thereunder during his life. The agreement provided that the validity and effect of the trust should be governed by the laws of the State of New York. Upon Daniel's death, income was payable to Marie for life, with subsequent disposition provided for by other clauses not relevant here. All premiums on the policies, both before and after the creation of the Insurance Trust, were paid by Daniel from community property.

Chase is the successor to Equitable as trustee under both trusts, and is still qualified and acting in such capacity. It succeeded Equitable in 1930.

On April 3, 1948, petitioner held cash and securities of a total value of $640,480.49 as trustee under the Inter Vivos Trust. The value of Marie's life interest in one-half of the principal thereof on that date was $128,689.18, and the value of her life interest in the entire corpus thereof was then $257,378.37.

Following Daniel's death on April 3, 1948, petitioner received in its capacity as trustee under the Insurance Trust proceeds of insurance policies on Daniel's life in the total amount of $239,014.04. All such policies had been taken out between 1923 and 1940, inclusive, and had been made payable to petitioner as trustee. The value on the date of Daniel's death of Marie's life interest in one-half of the Insurance Trust was $48,024.13. The value of her life interest in the entire Insurance Trust on that date was $96,048.25.

Daniel's will was duly admitted to probate in the County Court of Harris County, in the State of Texas, on or about

May 26, 1948. Chase and another were nominated as executors, but Chase did not qualify. The will created a residuary trust (hereinafter called the Testamentary Trust) of which Chase was appointed trustee, and is still so acting. The Testamentary Trust attempted to dispose of the bulk of the property held by Daniel and Marie as community property, other than property purportedly disposed of prior to the date of Daniel's death. Marie received a life estate therein, with subsequent disposition governed by provisions of no relevance here. The provision for Marie was expressly stated to be in lieu of all rights due her as Daniel's surviving spouse. The trustee was given a broad discretionary power to distribute principal to any beneficiary. It was requested to exercise such discretion liberally, but its decision was made final and conclusive.

Chase was appointed ancillary executor by the Surrogate Court of New York County, in the State of New York, and ancillary letters testamentary were issued on August 2, 1948. Chase is still qualified and acting in such capacity.

The total value of the principal of the Testamentary Trust on April 3, 1948, was $1,010,844.62. The value of Marie's life interest on that date in one-half of that trust was $203,104.94, and in the entire trust was $406,209.88.

Since the date of Daniel's death Marie has received and accepted without protest income from each of the foregoing three trusts in accordance with their respective terms. Prior to Daniel's death, Marie had no knowledge of the existence of the trust agreements or the provisions of Daniel's will.

Respondent has determined a gift tax deficiency on the ground that when Marie accepted the benefits of the trusts she acquiesced therein and thereby surrendered and made taxable gifts to the remaindermen of her community interest in the principal of each trust, less the value of the life estate retained by her in such interest. The community

interest given up is claimed by respondent to be one-half of the principal of the Inter Vivos Trust and Testamentary Trust, and one-half of the proceeds of the policies held by petitioner as trustee under the Insurance Trust.

This deficiency has been determined against petitioner as trustee and transferee. No part thereof has ever been assessed against Marie, nor any attempt made to collect any part of it from her. No part of such deficiency has been paid by Marie or by petitioner. No claim is made that Marie is or ever was insolvent, or that the transfers alleged to have been made by her rendered her unable to pay the full amount of any gift tax thereon. The determination of a deficiency against petitioner was first made after expiration of the time within which a gift tax deficiency could have been determined against Marie.

OPINION.

RAUM, *Judge:* Respondent has determined that Marie had a community property interest in the three trusts, consisting of one-half of the principal of the Inter Vivos Trust and Testamentary Trust and one-half of the proceeds of the policies in the Insurance Trust. She had the right to demand and receive, subject only to the payment of community debts, any community property interest she may have had after coverture ended as a result of Daniel's death. It is respondent's position that in failing to demand the interest which he has determined she owned at the death of her husband, she relinquished that interest and thereby made taxable gifts to the remaindermen under each trust to the extent of her community interest therein less the life estate reserved in that interest.

Petitioner, on the other hand, denies that any taxable gift was made by Marie after Daniel's death. It insists that there was no donative intent, and that Marie simply exchanged

her community property rights, if any, for life interests in a larger principal in a transaction deemed by her to be to her economic advantage. It then argues that if it should be held that there were taxable gifts, the value of such gifts should consist of the value of the interest transferred less not merely the value of the life interest retained by Marie in her one-half, but the value of her life estate in the entire property, in the case of each trust. It also contends that in the case of the Insurance Trust and the Inter Vivos Trust, Marie did not have a community property interest at the date of Daniel's death, because any such interest, according to petitioner, ended when the trusts were created back in 1928. Finally, it is contended that irrespective of the merits, a deficiency cannot be determined against petitioner, because no timely attempt was ever made to collect the deficiency from Marie, and there is no showing that Marie is insolvent or financially unable to pay the amount of tax claimed by respondent to be due.

It is not necessary to the operation of the gift tax that the donor affirmatively go through a ritual of making a gift. The basic gift tax provisions before us have been continuously in effect since 1932, and the report of the House Ways and Means Committee accompanying the bill which ultimately became the Revenue Act of 1932 stated (H.R. Rept. No. 708, 72d Cong., 1st Sess., p. 27):

> The terms "property", "transfer", "gift", and "indirectly" are used in the broadest and most comprehensive sense; * * *

See also S. Rept. No. 665, 72d Cong., 1st Sess., p. 39; *Smith* v. *Shaughnessy*, 318 U.S. 176, 180. It has been established that the failure to exercise a right to recapture property or to disaffirm a voidable or revocable transfer may itself constitute an effective transfer of the property subject to gift tax. *Commissioner* v. *Allen*, 108 F. 2d 961 (C.A. 3), cer-

tiorari denied 309 U.S. 680; *Adele F. Goodman*, 4 T.C. 191, affirmed 156 F. 2d 218 (C.A. 2). Accordingly, if Marie had community property rights in the corpora of the three trusts which she abandoned in favor of the life interests which she accepted, she has plainly made gifts to the extent that the value of the interests thus surrendered exceeded the value of her life estates. It has been stipulated that Daniel at no relevant time owned any separate property, and it follows that the corpus of each of the trusts had its source in community property of Daniel and Marie. It thus becomes necessary to examine Marie's position under Texas law respecting community property.

In Texas, a wife's interest in community property is not a mere expectancy. It is vested, and equal to that of her husband. *Hopkins* v. *Bacon*, 282 U.S. 122, 126; *Johnson* v. *Commissioner*, 88 F. 2d 952, 954 (C.A. 8); *Edwards* v. *Edwards*, 108 Okla. 93, 101, 233 Pac. 477, 485. During coverture the husband, while he continues to honor his duties as the head of the family, has complete and exclusive right of management and control over the property thus owned by the community. He may dispose of such property in any manner he sees fit, as long as he does not act with the purpose of defrauding his wife, and may even make gifts therefrom. Cf. *Locke* v. *Locke*, 143 S.W. 2d 637, 638 (Tex. Civ. App.); *Shaw* v. *Shaw*, 28 S.W. 2d 173, 176 (Tex. Civ. App.).

In all that he does with respect to community property, however, the husband acts not as an owner, but as the active or managing member of the community. There is no common-law concept exactly congruous to his relation to community property. In Texas he is said to be like a trustee. Cf. *King* v. *Bruce*, 145 Tex. 647, 654, 201 S.W. 2d 803, 807, certiorari denied 332 U.S. 769; *Arnold* v. *Leonard*, 114 Tex. 535, 545, 273 S.W. 799, 804. Whatever the terminology, however, it is clear that in Texas the wife is a present owner of

a one-half interest in all community property. *Arnold* v. *Leonard*, *supra*. When coverture ends as a result of the death of the husband, or for some other reason, this interest becomes the separate property of the wife, and her interest becomes active and possessory rather than passive as it had been during coverture, subject only to the payment of community debts. Cf. *Sneed* v. *Commissioner*, 220 F. 2d 313, 314 (C.A. 5); *Waterman Lumber & Supply Co.* v. *Robins*, 159 S.W. 360, 364, 365 (Tex. Civ. App.), modified 206 S.W. 825 (Com. App.). Thus, while the husband, in disposing of the entire "bundle of rights," may in some circumstances dispose of the wife's interest along with his own, he cannot tranfer or extinguish merely her rights while retaining his own, or convert community property into his separate property. Cf. *Keller* v. *Keller*, 135 Tex. 260, 267, 141 S.W. 2d 308, 311; *Rowlett* v. *Mitchell*, 52 Tex. Civ. App. 589, 592, 114 S.W. 845, 847; *Martin* v. *Moran*, 11 Tex. Civ. App. 509, 511, 32 S.W. 904, 906.

We now turn to the three trusts in question, beginning with the Inter Vivos Trust.

The Inter Vivos Trust.

This trust was clearly testamentary. Daniel gave away nothing while he lived. Not only did he reserve the income to himself for life, but he retained plenary powers to revoke and, in effect, deal with the corpus as though no trust had been created. The rights and powers retained by him amounted to full beneficial ownership. Such a trust would clearly be ineffective to shift the incidence of the Federal income tax. Cf. sec. 166, I.R.C. 1939; *Helvering* v. *Clifford*, 309 U.S. 331. Petitioner has cited no authority to the effect that under the laws of Texas it would be deemed sufficient to pass a present interest, and the decisions of the Texas courts indicate otherwise. Cf. *Armington* v. *Gilcrease Oil Co.*,

190 S.W. 2d 587, 595 (Tex. Civ. App.); *Fleck* v. *Baldwin*, 141 Tex. 340, 345, 172 S.W. 2d 975, 978. And see *Bridewell* v. *Clay*, 185 S.W. 2d 170, 172 (Tex. Civ. App.); *Postal Mut. Indemnity Co.* v. *Penn*, 165 S.W. 2d 495, 499 (Tex. Civ. App.). The principal of the trust thus remained community property after as well as before the transaction of November 2, 1928. Any transfer made thereby can be effective, if at all, only as a testamentary transfer. A testamentary disposition by the husband of community property purportedly including his wife's interest as well as his own is not binding on the wife, and cannot deprive her of her interest in such property unless she elects to abide by the terms thereof. Cf. *Delevan* v. *Thom*, 244 S.W. 2d 551, 554 (Tex. Civ. App.); *Rowlett* v. *Mitchell, supra*, 52 Tex. Civ. App. at p. 592, 114 S.W. at p. 847; *Martin* v. *Moran, supra*, 11 Tex. Civ. App. at p. 511, 32 S.W. at p. 905.

Nor is the result affected by the application of section 12-a[1] of the Personal Property Law of New York. Under these provisions a trust established by a nonresident settlor may be so created as to be governed as to validity and effect by the laws of New York. Assuming that petitioner is correct in its contention as to the comprehensive scope of these provisions, the same result must follow even under New York law. It is well settled in New York that a purported transfer by a spouse, whereby the transferor retains

[1] § 12-a. Validity of trusts of personal property.

Whenever a person being a citizen of the United States, or a citizen or a subject of a foreign country, wherever resident, creates a trust of personal property situated within this state at the time of the creation thereof, or of which the trustee is a resident of this state, or a domestic corporation or national bank located within this state, duly authorized by law to act as trustee, and declares in the instrument creating such trust that it shall be construed and regulated by the laws of this state, the validity and effect of such trust shall be determined by such laws.

during his lifetime in substance the same control and enjoyment of rights he had in respect of such property prior to the transfer is illusory, and cannot deprive a surviving spouse of her right to an intestate or elective share in such property. *Newman* v. *Dore*, 275 N.Y. 371, 377, 379, 9 N.E. 2d 966, 968, 969; *Hirschfield* v. *Ralston*, 66 N.Y.S. 2d 59, 61; *In re Sanchez' Estate*, 58 N.Y.S. 2d 230, 238. Moreover, such transfers are deemed "fraudulent" as to such surviving spouse, the lack of bona fides relating not to any intent to deprive the survivor of an elective or intestate share, but rather to the absence of any intent on the part of the transferor to divest himself of what he purports to transfer. Cf. *Newman* v. *Dore, supra*, 275 N.Y. at p. 379, 9 N.E. 2d at p. 969; *Hart* v. *Hart*, 81 N.Y.S. 2d 764, 767; *In re Sanchez' Estate, supra*, at p. 238.

In New York the right of a surviving spouse to share in the estate as an elective or statutory heir is a mere expectancy. Cf. *Newman* v. *Dore, supra*, 275 N.Y. at p. 376, 9 N.E. 2d at p. 967; *Brindisi* v. *Stallone*, 21 N.Y.S. 2d 29, 31. A transfer deemed illusory and ineffective as to such surviving spouse must *a fortiori* be incompetent to divest a spouse of a community property interest which *vested* prior to the making of such transfer.

Apart from the foregoing analysis of New York law, an even more compelling reason dictates the result to be reached. The power of any State to divest vested property rights merely because property has been transferred to its physical jurisdiction, or even because the owners of interests therein have changed their residence to such jurisdiction raises serious constitutional questions. Cf. *Abraham B. Johnson et al.*, 7 B.T.A. 820, 831; *Brookman* v. *Durkee*, 46 Wash. 578, 583, 90 Pac. 914, 915. It has often been held that in such circumstances community property is not converted into separate property or separate property into

community property. Cf. *Johnson* v. *Commissioner*, *supra*, 88 F. 2d at p. 955; *Estate of Emma Frye*, 44 B.T.A. 835, 842; *Robert H. Lord*, 30 B.T.A. 425, 428; *T. C. Phillips*, 9 B.T.A. 153, 156; *King* v. *Bruce*, *supra*, 145 Tex. 647, 654, 201 S.W. 2d 803, 807; *Edwards* v. *Edwards*, *supra*, 108 Okla. at p. 101, 233 P. 2d at p. 485; *Succession of Popp*, 146 La. 464, 472, 83 So. 765, 768. And see *In re Thornton's Estate*, 1 Cal. 2d 1, 33 P. 2d 1, where the Supreme Court of California held unconstitutional a statute of that State purporting to change separate property of a spouse into community property upon a change of residence from a non-community property State to California.

Assuming the validity and effect of the Inter Vivos Trust to be governed generally by the laws of New York, it does not follow that New York would attempt to go so far as to divest previously vested property rights under the guise of applying its general rules of law to the trust in question, merely because similar rights would not have been acquired in New York under the same facts. The words of section 12-a do not require such a construction, and it is highly doubtful that the courts of New York would needlessly adopt a construction of its laws which would raise the foregoing constitutional question. Nor has petitioner brought to our attention any authority which indicates that in New York there is any doubt as to the validity of community property interests acquired elsewhere. We therefore hold that since Daniel in no way changed his relation to the trust property Marie's interest was likewise unaffected. When she chose to abide by the terms of the trust by accepting payments of income thereunder, she elected to waive and surrender her community property interest in the principal thereof, and thereby made a taxable gift.

It is of no consequence that, as contended by petitioner, Marie may have considered the transaction to be advantageous to her. Neither section 1002 of the Internal Reve-

nue Code of 1939[2] nor section 86.8 of Regulations 108[3] promulgated thereunder limits the imposition of the gift tax to transfers falling within the classic common-law concept of gifts. Section 1002 includes as a taxable gift a transfer of property "for less than an adequate and full consideration in money or money's worth." Thus a taxable gift may be made despite the fact that something of value may have been received in exchange for the property constituting the subject matter of the gift, where the property received is less in "money or money's worth" than that transferred. In such case there is a taxable gift to the extent that "the value of the property exceeded the value of the consideration." The regulations recognize an exception to the literal words of the statute where there is an arm's-length bargaining situation without any donative intent, and one party has simply made a better bargain for itself than has

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[2] SEC. 1002. TRANSFER FOR LESS THAN ADEQUATE AND FULL CONSIDERATION.

Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this chapter, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

[3] Sec. 86.8. TRANSFERS FOR A CONSIDERATION IN MONEY OR MONEY'S WORTH. — Transfers reached by the statute are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration in money or money's worth to the extent that the value of the property transferred by the donor exceeds the value of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a money value, as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift.

the other. We are satisfied from the entire record, however, that there was here no such arm's-length relationship of persons bargaining one with the other "in the ordinary course of business," and the words of section 1002 must therefore be literally applied. Cf. *Robinette* v. *Helvering*, 318 U.S. 184, 188.

The next issue is the amount of the gift. Respondent contends that the gift consisted of the value of Marie's one-half interest in the principal less the value of a life estate in one-half of the principal. We agree with petitioner, however, that the value of the gift must be reduced by the value of the life estate received by Marie in the entire principal. By failing to assert her community property rights, Marie made a gift of her one-half interest in the principal minus her life estate in the entire principal. The trust which she accepted in lieu of her community property interest in the principal was a single package; there were not two trusts, one based upon the principal representing her one-half and the other upon her husband's one-half; and we know of no basis under Texas law whereby she could have disaffirmed one-half of the trust while at the same time retaining the benefits of the other one-half. Indeed, in the Testamentary Trust, hereinafter considered, the instrument expressly stated that the provision for Marie was to be in lieu of all rights due her as surviving spouse; and what was explicit in that trust was plainly implicit in the Inter Vivos Trust. What she in fact did was to accept the trust which gave her a life estate in the entire principal in exchange for her full interest in one-half of the principal.

The Insurance Trust.

Daniel retained virtually the same degree of control over this trust during his lifetime as he did with respect to the trust already discussed, and the premiums were paid with

community funds. Superficially, it would seem, therefore, that the same result should be reached here as in the case of the other trust. However, there appear to be differences in the law of Texas with respect to the surviving spouse's interest in the proceeds of life insurance policies that call for a different result.

It is true that under Texas law the wife is regarded as having a community property interest in the cash surrender value of policies on the husband's life where the premiums were paid out of community funds; and, in the event of termination of coverture during the lifetime of the spouses, the wife may successfully assert her rights to a one-half interest in an amount equal to such cash surrender value. *Womack* v. *Womack*, 144 Tex. 299, 172 S.W. 2d 307; *Berdoll* v. *Berdoll*, 145 S.W. 2d 227 (Tex. Civ. App.); *Locke* v. *Locke*, 143 S.W. 2d 637 (Tex. Civ. App.); *Russell* v. *Russell*, 79 S.W. 2d 639 (Tex. Civ. App.). Cf. *Joe J. Perkins*, 1 T.C. 982, 985. However, the law of Texas appears to be that where the marriage is terminated by the death of the husband, the *proceeds* of the policies are payable to the named beneficiary and the wife does not have any community property interest that can be asserted against such proceeds. Cf. *Jones* v. *Jones*, 146 S.W. 265, 269 (Tex. Civ. App.); *Rowlett* v. *Mitchell*, *supra*, 52 Tex. Civ. App. at p. 592, 114 S.W. at p. 847; *Martin* v. *McAllister*, 94 Tex. 567, 569, 63 S.W. 624, 625. Furthermore, it has been held that upon the death of the insured husband any cash surrender value the policy may have had during his lifetime lapses, and no claim based upon a supposed interest in such cash surrender value can succeed. *Volunteer Life Ins. Co.* v. *Hardin*, 145 Tex. 245, 197 S.W. 2d 105; *San Jacinto Bldg.* v. *Brown*, 79 S.W. 2d 164 (Tex. Civ. App.).

The distinction may appear to be a bit unusual, but we must take the law of Texas as we find it. Until the Texas

courts indicate otherwise, we must assume that the foregoing cases correctly establish the law of Texas, and they appear to hold that the wife has no community property interest in the proceeds of the policies upon the husband's death. In the circumstances, Marie did not have any community property rights in the insurance trust upon Daniel's death, and therefore cannot be treated as having made a gift based upon her failure to assert such rights.

The Testamentary Trust.

The principal of this trust was admittedly owned by the community up to the time of Daniel's death. The factors requiring us to hold that a taxable gift was made in respect of the Inter Vivos Trust apply with at least as much force here. *Delevan* v. *Thom*, 244 S.W. 2d 551, 554 (Tex. Civ. App.); *Rowlett* v. *Mitchell*, 52 Tex. Civ. App. 589, 592, 114 S.W. 845, 847; *Martin* v. *Moran*, 11 Tex. Civ. App. 509, 511, 32 S.W. 904, 905. We therefore hold that Marie's acquiescence in this trust constituted a taxable gift to the extent of her community one-half of the principal less the life estate reserved by her therein, reduced by the value of the life estate received by her in the other one-half of the trust as consideration.

In determining the value of the gift made by Marie in respect of the Testamentary Trust we have not ignored the provision conferring upon the trustee the discretionary power to distribute principal. This power is one which the trustee has the right to use or not to use, as it wishes, but it does not represent anything given to or received by Marie that is capable of valuation. Petitioner has cited authority to the effect that under the laws of New York such a provision enables a trustee to distribute to the income beneficiary the entire corpus of the trust. *In re Visconti's Will*, 306 N.Y. 442, 119 N.E. 2d 34. But it has cited

no case, and we know of none, which permits the beneficiary, by virtue of such provision, to require the trustee to distribute any part of the principal of a trust against its wishes. The amount of the taxable gift may not be reduced by reason of a possibility, over which Marie had no control and which is incapable of valuation, that the corpus or a part of it might be paid over to her. Cf. *Robinette* v. *Helvering*, 318 U.S. 184, 188-189.

Transferee Liability.

Petitioner takes the position that it may not be proceeded against as a transferee because no action was ever taken by respondent to collect the deficiency from the donor, there is no showing that she is or ever was insolvent or unable to pay the amount of the deficiency, and the deficiency was first asserted against petitioner as transferee after expiration of the time within which the deficiency could have been asserted against Marie.

The liability of a transferee for gift tax due from its transferor is governed by section 1025 of the Internal Revenue Code of 1939.[4] It has been consistently held that under

[4] SEC. 1025. TRANSFERRED ASSETS.

(a) METHOD OF COLLECTION. — The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in the tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) TRANSFEREES. — The liability, at law or in equity, of a transferee of property of a donor, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed by this chapter.

(2) FIDUCIARIES. — The liability of a fiduciary under section 3467 of the Revised Statutes (U.S.C., Title 31, § 192) in

that provision the only requirement for the assertion of a deficiency in gift tax against a transferee is that the transferor did incur a gift tax liability and failed to pay such tax when due. The conditions necessary for the assertion of an *income* tax liability of a transferor against a transferee do not apply here. *Mississippi Valley Trust Co. v. Commissioner*, 147 F. 2d 186 (C.A. 8); *Baur v. Commissioner*, 145 F. 2d 338 (C.A. 3); *Evelyn N. Moore*, 1 T.C. 14, affirmed 146 F. 2d 824 (C.A. 2); *Fletcher Trust Co., Trustee*, 1 T.C. 798, affirmed 141 F. 2d 36 (C.A. 7), certiorari denied 323 U.S. 711. The foregoing cases require that this issue be resolved against the petitioner.

Reviewed by the Court.

Decision will be entered under Rule 50.

MURDOCK, *J.*, dissenting: I think that the Commissioner correctly determined the amounts of the gifts and those gifts should not be further reduced by the value of Marie's life estate in that property which was contributed to the trusts by her deceased husband.

The theory of the majority opinion is that the husband in paragraph FIFTH of his will intended to put into his residuary testamentary trust not only his own share of the property of the community which was dissolved by his death but also Marie's share; Marie would lose her life estate in the property contributed to that trust by her husband unless she permitted her share of the community property to be included in that trust; and since she allowed her property

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respect of the payment of any such tax from the estate of the donor.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) PERIOD OF LIMITATION. — The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) Within one year after the expiration of the period of limitation for assessment against the donor.

to go into the trust she received as consideration for that transfer her life estate in the property contributed to the trust by her husband.

Her husband had no legal right to dispose of her property by his will, and it seems wrong to conclude as a matter of law that he did so under the terms of paragraph FIFTH of his will. I do not understand how he could impose binding conditions in his will dependent solely upon what Marie would do with her own property. Paragraph SEVENTEENTH of the will imposed no real penalty upon Marie had she chosen to consider that her share of the community property following the death of her husband was not included in his testamentary trust. It does not appear that under the laws of Texas she had any dower rights or other rights, as the widow of her deceased husband, of the kind mentioned in paragraph SEVENTEENTH. Certainly she did not acquire her right to one-half of the community property as widow of her deceased husband. She had that right during their marriage. Had she accepted the FIFTH paragraph of his will as applying to the property owned by her husband at the time of his death but not as applying to her property at that time, she could have received the life estate in the property which he properly and legally placed in his testamentary trust and her transfer to the same trust of property which belonged to her at the death of her husband was not consideration for the life estate which her husband gave her in his property.

The position of the majority in relation to the Inter Vivos Trust seems definitely weaker because as to that trust there was no condition whatsoever attached so far as the Findings of Fact show, and I see no reason why Marie, when she learned about the trust for the first time at the death of her husband, could not have withdrawn her property from that trust and at the same time enjoyed the life estate in the property of her deceased husband which would then remain in the trust.

Tax Court Decision

THE TAX COURT OF THE UNITED STATES

Docket No. 48652

THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, Trustee and alleged transferee of Marie Elizabeth Moran,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

(June 19, 1956)

Pursuant to the findings of fact and opinion filed herein December 22, 1955, directing that decision be entered under Rule 50, the parties, on June 12, 1956, filed an agreed computation for entry of decision. It is therefore

ORDERED and DECIDED: That there is a deficiency in gift tax for the taxable year 1948 in the amount of $27,426.06.

ARNOLD RAUM
Judge

Court of Appeals Opinion

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 16488

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

THE CHASE MANHATTAN BANK, Successor of The Chase National Bank of the City of New York, trustee and Alleged transferee of Marie Elizabeth Moran,

Respondent.

(and reverse title)

Petitions for Review of Decision of the Tax Court of the United States (District of Texas)

(August 19, 1958)
(259 F. 2d 231)

Before CAMERON, JONES, and WISDOM,
Circuit Judges.

WISDOM, Circuit Judge: This case turns on the community property law of Texas.[1] Stated broadly, the ques-

[1] (a) In general, see de Funiak, Principles of Community Property (1943); McKay, Community Property (1925); Speer, Law of Marital Rights in Texas (1929); Huie, The Community Prop-

tion before us is the gift tax effects of trusts and insurance in a community property state where the wife has a present, vested ownership of half the marital community in her own right.

The proceedings are brought to this Court by a petition and a cross-petition for review of a Tax Court decision concerning the transferee liability of the taxpayer, Chase Manhattan Bank, successor to Chase National Bank of New York, for gift taxes for the year 1948. The alleged transferor is Mrs. Marie Elizabeth Moran, widow of Daniel J.

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erty Law of Texas, 13 Vernon's Ann. Tex. Civ. Stat., VII-XLVI (1951); Haddaway, Community Property in the Administration of Estates, 33 Tex. L. Rev. 1012 (1955); Childress, Community Property in the Administration of Estates in Texas, Proc. Tex. Inst., 5th Annual Tax Conf. (1957), p. 155. Of special historical interest: Schmidt, Civil Law of Spain and Mexico (N. O. 1851).

(b) Jackson, Community Property and Federal Taxes, 12 Sw. L. J. 1 (1958); Huie, Community Property and Life Insurance, Proc. Tex. Inst., 5th Ann. Tax. Conf. (1957), p. 118; Morrison, Life Insurance—Tax Aspects, Proc. Tex. Inst., 5th Ann. Tax Conf. (1957), p. 142; Thurman, Estate Tax on Insurance, 9 Stan. L. Rev. 238 (1957); Stephens, Life Insurance and Community Property in Texas—Revised, 10 Sw. L. J. 343 (1956); Hammond and Ray, Federal Tax Problems in Community Problems, 8 Sw. L. J. 127 (1954); Benjamin and Pigman, Federal Estate and Gift Taxation of Louisiana Life Insurance, 28 Tul. L. Rev. 75, 243 (1954); Eichenbaum, Estate Taxation of Insurance Proceeds in Community Property, 1952 Tul. Tax Inst., p. 251; Swift, House Bill 900 and Your Life Insurance Policy, 20 Tex. Bar J. No. 11, p. 691 (1957); Sterling, note on Warthan v. Haynes, 35 Tex. L. Rev. 449 (1957); Note—36 Tex. L. Rev. 92 (1957).

(c) See especially, Huie, Community Property Law as Applied to Life Insurance, 17 Tex. L. Rev. 121 (1939); 18 Tex. L. Rev. 121 (1940); Collection of Articles in U. of Texas Institutes, Business and Family Planning, Proc. 5th Ann. Tax. Conf. (1957).

(d) See also Nabors, Civil Law Influences upon the Law of Insurance in Louisiana, 6 Tulane L. Rev. 515 (1932); Young, Taxation of Community Life Insurance, 13 Tul. L. Rev. 421 (1939); Daggett, the Community Property System of Louisiana (2nd Ed., 1932); Cahn, Civil Law as applied to Life Insurance, 12 La. L. Rev. 56 (1951).

Moran.[2] Marie is alleged to have made gifts of her share of her community property by "acquiescing" in the benefits of three trusts — an insurance trust, a living trust, and a testamentary trust — established by her husband.[3]

I. The Three Trusts.

Daniel James Moran and Marie Elizabeth Moran were married before 1922 and remained husband and wife until Daniel died April 3, 1948. Their legal domicile was Texas during their entire married life. Daniel had no separate property.

November 2, 1928, in New York, Daniel created a living trust naming as trustee, The Equitable Trust Company, a predecessor to Chase. The trust estate consisted of securities belonging to the community. Income was payable to Daniel for life, then to Marie for life, with the remainder to the settlor's descendants. Daniel reserved the right to modify or revoke the trust. He reserved no powers of control over the administration of the trust.

November 2, 1928 Daniel also created an insurance trust with the same trustee. The trust estate consisted of insurance policies on Daniel's life. Daniel paid the insurance premiums with community funds. He reserved the right to

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[2] Marie filed a gift tax return for 1948 with the Collector of Internal Revenue for the First District of Texas. Venue on appeal therefore lies with this Court under Section 7482 of the 1954 Code. Since no return was filed by Chase, the transferee-taxpayer, the parties have stipulated for review by this Court in order to avoid any possible question as to venue.

[3] None of the deficiency determined against Chase as trustee and transferee was assessed against Marie. No claim was made that Marie was insolvent or that she was unable to pay the full amount of any gift tax that might be due. The determination of a deficiency against Chase was made after expiration of the time within which a gift tax deficiency could have been determined against Marie. See Section 1025, Internal Revenue Code of 1939.

modify or revoke the trust; and under the policies he had the right to change the beneficiaries. Upon Daniel's death the insurance proceeds were payable to the trustee. Income was payable to Marie for life, with the remainder to the settlor's descendants. The insurance trust agreement provides that the validity and effect of the trust shall be governed by the law of New York; the living trust instrument contains a similar provision.

Daniel's will provided for a testamentary trust of his residuary estate, Marie to receive the income for life, the remainder to be divided among Daniel's descendants. Chase, the trustee, was given broad discretionary power to distribute principal to any beneficiary.

II. Conflicting Contentions.

A. The Commissioner held that on Daniel's death the living trust and insurance trust became irrevocable and the testamentary trust came into being. (1) As to the testamentary trust, the Commissioner took the position that Marie was put to an election under Daniel's will and that she elected to take under the will, relinquishing her half of the community for a life estate in that half. (2) As to the living trust, the Commissioner held that it became a completed gift by husband and wife when Daniel died without having exercised his right of revocation. (3) Section 86.2(a) of Treasury Regulations 108 specifically covers insurance payable revocably to a third person and purchased with community funds. The Commissioner held that on the husband's death there was a gift by the wife of one-half the amount of the proceeds of the insurance.

The Commissioner valued the gift to each trust as the difference between what he thought that Marie gave up (her community one-half share of the trust estate) and what she retained (a life estate in her one-half). The resulting de-

ficiency for the three trusts amounted to $133,378.88.[4] This was assessed against Chase as trustee and transferee, under Section 1025 of the Internal Revenue Code of 1939.

B. Chase, represented by the same New York lawyers who drew the trusts and the will,[5] filed a petition in the Tax Court, contending that Marie had made no taxable gifts; but, if she had, that the Commissioner's measure of each gift should be reduced by the value of the life estate she received in her husband's one-half of each trust. (1) Chase's petition, filed May 22, 1953, stated that the estate was still under administration and that *"no determination has yet been made as to whether or not the said Marie Elizabeth Moran has elected to take under the will"*. The petition alleges however, that "upon information and belief", Marie's motive "*in not taking against* the will was to benefit herself" and that her "failure to take against the will . . . was an arms length transaction . . . entered into by Marie upon the advice of her attorney . . . as economically advantageous". (2) As to the living trust and (3) insurance trust, Chase insisted that Marie had no community interest at the time of Daniel's death; her community interest was transferred when the trusts were created in 1928. As in the

[4] (1) On April 3, 1948, the date of Daniel's death, the principal of the living trust amounted to $640,480.49. Marie's life interest in one-half of that principal would be worth $128,689.18; the value of her life interest in the entire trust estate would be $257,378.37. (2) The proceeds of the insurance policies paid to the trustee on Daniel's death amounted to $239,014.04. The value of Marie's life interest in one-half of the insurance trust would be $48,024.13; the value of her life interest in the entire trust estate would be $96,048.25. (3) The value of the principal of the residuary trust on April 3, 1948, was $1,010,844.25. The value of Marie's life interest in one-half of that trust would be $203,104.94; and in the entire trust estate would be $406,209.88.

[5] The will named Chase as Co-Executor with Charles A. Perlitz. Chase did not qualify but it was appointed as Ancillary Executor in New York.

case of the testamentary trust, Chase claimed that Marie's transfers were "business transactions . . . for her own benefit".

Marie did not join in the petition. Marie did not testify. There is no testimony in the record as to Marie's alleged "motives". There is none as to any "arms length" negotiations between Marie and the trustee. There is no evidence as to any affirmative act by Marie showing an intention to transfer any interest to Chase. The stipulation of facts was between Chase and the Commissioner. It has one short unenlightening paragraph referring to Marie's receipt of income from the trusts:

> "Marie Elizabeth Moran has, since the date of decedent's death received income from each of the three trusts referred to above in accordance with the provisions of the said trust agreements and of the will of Daniel J. Moran."

One witness testified, briefly. Charles A. Perlitz, Executor, stated that: he informed Marie he would collect the properties in the estate and turn them over to Chase; "Mrs. Moran had had no experience in business matters whatever": she knew nothing about the trusts; she had never asked if she had a right to move against the trusts or the will; he did not "volunteer that she might have some right to bring suit against the trustees"; "somewhere down the line when I told her that she ought to make a will or someone, I think the lawyers probating the will, told her she ought to make a will, and then there was some reference there to her community interest and whether she should take on the will or not — under the will — but that was long subsequent to the time when the will had been probated".

At the trial the Commissioner and Chase agreed in assuming that Daniel's will put Marie to an election. Appar-

ently, they agreed also that Marie's receipt of income from the trust was sufficient to show that she had elected to take under the will. They differed only as to whether the effect of the election was that she had made a taxable gift.

Chase, in its petition and at the trial, alleged that Daniel provided a trust for his wife "of his entire residuary estate, *including the property that Marie Elizabeth Moran owned with him in community*". This, we must point out now, is a contradiction in terms. Daniel Moran could put his wife to an election. But Daniel Moran's residuary estate could no more include his wife's one-half of the community property than it could include Chase Manhattan's properties on Pine Street in the city of New York.

C. A majority of the Tax Court, held that Daniel's will put Marie to an election and that Marie's "acquiescence" in the testamentary trust constituted a taxable gift. The Court held that the living trust was testamentary, that Daniel gave away nothing while he lived, and the principal remained community property. When, however, Marie acquiesced in the trust by accepting the income, she thereby elected to surrender her community property interest in the principal. This, said the Court, was a taxable gift. The Tax Court agreed with Chase that the value of each gift was one-half of the value of the principal less the life estate in the whole. The tax deficiency was fixed at $27,426.06; plus interest amounting to $12,189.20.

As for the insurance trust, the Tax Court held that, under the law of Texas, a surviving wife has no community property interest in the proceeds of policies payable to a third party beneficiary. Marie's failure, therefore, to assert such rights could not be treated as constituting a taxable gift. The *logically necessary extension of this holding would require that the entire amount of insurance proceeds be included in the gross estate of a deceased husband in Texas*

(and perhaps in other community property states) — when a husband insures his life in favor of a trustee or other third person beneficiary, using community funds to pay the premiums, and reserving the right to change the beneficiary.[6]

D. Alarmed at this turn, mainly with respect to the insurance trust but also disagreeing on the valuation of the gifts of Marie's interests in the other trusts,[7] the Commissioner filed a motion for reconsideration. The Tax Court reaffirmed its original decision. The Commissioner appealed.

Chase, trustee, cross appealed, represented by Texas attorneys. Now, for the first time in the case, the point is made that in Texas a deceased husband's residuary estate does not include his wife's share of the community; that Daniel's will does not purport to dispose of Marie's share and therefore she was not put to an election. If Marie transferred her share to the trust, which Chase, the trustee, in this Court *now* denies, the transfer is said at most to create a revocable trust not subject to a gift tax in 1948. For various reasons, some new in the proceedings, Chase contends that Marie did not make a gift of her interest in the living trust or in the insurance trust; but, if she did,

[6] The proceeds of the insurance policy were included in full in the taxable estate of Daniel J. Moran and an estate tax deficiency based upon that assumption claimed by the Commissioner of Internal Revenue was paid by the Executor of the Estate of Daniel J. Moran. The Commissioner is now asserting a deficiency in gift tax with respect to one-half of the proceeds held by the trustee, upon which he has already collected an estate tax deficiency based upon the inclusion of the entire proceeds in Moran's taxable estate.

[7] A similar question on the gift tax valuation of a wife's election to take under her husband's will was then pending in the 9th Cir. and has since been decided in the taxpayer's favor. Commissioner v. Siegel, 9 Cir., 1957, 250 F. 2d 339.

it is claimed that the value of such gift is half of the principal less her life estate in the whole. Chase is willing to agree with the Tax Court, that no taxes are owed on the insurance trust. Chase asserts that its transferee liability, if any, was limited to one-half of the cash-surrender value of such policies; the taxpayer relies on two recent Supreme Court cases.[8]

III. New Issue Raised on Appeal.

The Commissioner objects to the trustee now arguing that Marie was not put to an election. The taxpayer, the Commissioner contends, is not at liberty to urge as a ground for reversal a point not raised in the court below. Indeed, says the Commissioner, the taxpayer invited error. We think that the taxpayer did invite error. Worse, the invitation was accepted. But an appellant has no vested right in an opponent's error of the law in the lower court — especially when the protesting appellant is the Commissioner of Internal Revenue. The Commissioner owes a duty to the United States government to litigate zealously in the interest of collecting taxes. But he owes a duty to all taxpayers, including the litigating taxpayer, to see that the tax law is applied justly.

We sympathize with any litigant who has filed a brief on appeal and is then confronted with his opponent's brief raising a new issue. We sympathize also with Marie, who was not represented in the Tax Court proceedings and whose interests, to our way of thinking, were in conflict with the trustee's interests. And we sympathize with taxpayers generally who may be affected adversely if, contrary

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[8] United States v. Bess, 1958, ... U.S. ....., ... S. Ct. ....., 2 L. Ed. 2d 1135 and Commissioner v. Stern, 1958, ... U.S. ....., ... S. Ct. ....., 2 L. Ed. 2d 1126 And, of course, Rowen v. Commissioner, 2 Cir., 1954, 215 F. 2d 641.

to our convictions and understanding of the law, we allow an erroneous decision to go into the books and generate additional error.

Federal procedure is moving away from what Pound calls "the sporting theory of justice", Wigmore the "instinct of giving the game fair play", and Arthur Vanderbilt the theory of procedure as "a contest between two legal gladiators".[9] We are a Court "to secure a just . . . determination of every action". Rule 1, Federal Rules of Civil Procedure. Daniel's will was in the record and speaks for itself. "[W]here, as here, the case below was tried, not upon any misapprehension of the facts, but upon a misapprehension of the effects of those facts in law, appellant may not be prevented from pressing here for the application to the proven facts, of the correct principles of law." *Associated Indemnity Corp.* v. *Scott*, 5 Cir., 1939, 103 F. 2d 203, 209.

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[9] "The sporting theory of justice, the 'instinct of giving the game fair play', as Professor Wigmore has put it [1 Wigmore on Evidence, p. 127], is so rooted in the profession in America that most of us take it for a fundamental legal tenet. But it is probably only a survival of the days when a lawsuit was a fight between two claims . . . it is peculiar to Anglo-American law . . . In America we take it as a matter of course that a judge should be a mere umpire . . . The idea that procedure must of necessity be wholly contentious disfigures our judicial administration at every point. It leads the most conscientious judge to feel that he is merely to decide the contest, as counsel present it according to the rules of the game, not to search independently for truth and justice . . . It creates vested rights in errors of procedure, of the benefit whereof parties are not to be deprived. The inquiry is not, What do substantive law and justice require? Instead, the inquiry is, Have the rules of the game been carried out strictly? . . . put back the offending team five or ten or fifteen yards. . . ." Pound, The Causes of Popular Dissatisfaction with the Administration of Justice, 29 ABA Rep. 395 (1906). "The fundamental promise of the federal rules is that a trial [and its sequel, an appeal] is an orderly search for truth in the interest of justice rather than a contest between two legal gladiators with surprise and technicalities as their chief weapons . . ." Vanderbilt, Introduction to Cases and Materials on Modern Procedure and Judicial Administration (1952), p. 42.

"We see no reason why we should make what we think would be an erroneous decision, because the applicable law was not insisted upon by one of the parties." *Smith Engineering Co.* v. *Rice*, 9 Cir., 1938, 102 F. 2d 492, 499. Cf. *Erie* v. *Tompkins*, 1938, 304 U.S. 64, 58 S. Ct. 817, 826 Ed. 1188.

Tax liability as to the testamentary trust depends on whether Daniel's will put Marie to an election. The question is in the case. A just determination of the appeal requires us to decide it.

IV. The Community Property System.

For many years taxpayers in common law states, with a legitimate interest in tax uniformity, and taxpayers in community property states, with a legitimate interest in tax recognition of the realities of the community property system, were at cross purposes.[10] Finally, Congress enacted the equalization provisions of the Revenue Act of 1948 — to put taxpayers in all states on the same tax basis and at the same time recognize the logical tax effects of community property principles. It is important therefore that we weigh the issues carefully, in the interest of giving full weight to the community property law of Texas — while we give full weight to the tax laws of the United States. This takes a little doing.

A few basic principles characterize the community prop-

[10] There are eight traditional community property states: Louisiana, Texas, California, Washington, Arizona, New Mexico, Idaho, and Nevada. Texas derived its community property law from Spain by way of Mexico. Louisiana derived its community system from the Custom of Paris, then from Spanish law in 1769, and finally from the Code Napoleon. The laws of Texas and Louisiana on community property for the most part are substantially similar. The Bureau of Internal Revenue recognized their similarity as to insurance proceeds in Rev. Rul. 48, 1953-1, Cum. Bull. 392.

erty system. Their application here is determinative of the issues in this case. The community property system comes from the custom of the women of the Visigoths and other Germanic tribes sharing the fighting and the spoils of war with their men; it owes its strength to the civilized view that marriage is a full partnership. Husband and wife are equal partners. Each has a present, vested half interest in all community property. All property accumulated during marriage is community property, unless it is received by gift, devise, or inheritance.[11] In Texas and Louisiana even income derived from separate property belongs to the community including interest and dividends from separately owned securities. The husband is the manager of the community. But this management is not equivalent to ownership.[12] He acts as a managing agent or trustee or managing partner of a limited partnership. The husband may sell or donate community property but not in fraud of his wife's rights.[13] The earnings of the husband during marriage are community, and property purchased with such earnings is also community. The wife's rights, aside from managerial control, are the same as the husband's. Thus, on death or divorce the community is divided equally. Neither spouse has testamentary disposition over the other's half of the

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[11] Tex. Rev. Civ. Stat. Ann., Article 4619 provides that all property acquired by either husband or wife during marriage, except the separate property (Articles 4613, 4614) shall be deemed the common property of the husband and wife; and on dissolution of the marriage there is a presumption that all of the effects are as community.

[12] The wife has the management and control, if the husband becomes insane, or if he should disappear and his whereabouts be unknown for 12 months. Tex. Rev. Civ. Stat. Ann. Art. 3678. 4619.

[13] Arnold v. Leonard, 1925, 114 Tex. 535, 273 S.W. 799; Martin v. McAllister, 1901, 94 Tex. 567, 63 S.W. 624; Stamler v. Coe, 1855, 15 Tex. 211; Coss v. Coss, 1918, Tex. Civ. App., 207 S.W. 127.

community. The wife has complete testamentary disposition over her half and may leave it even to her paramour.[14] Upon the death of either spouse, a community property state levies an inheritance tax on the decedent's half of the community.[15] Since 1948 (and prior to 1942), only the decedent's half is includible in his gross estate for federal tax purposes.[16]

V. The Testamentary Trust.

Whether Marie made a taxable gift of her interest in the community to the trustee under Daniel's testamentary trust depends upon whether: (A) the will put her to an election and (B) she elected to take under the will.

A. If the provisions of a will require a legatee to surrender his property, or his statutory interest in property, to the executor or trustee as a condition to receiving the legacy, the legatee must make an election to take the legacy under the will or to renounce the will and preserve the rights which otherwise would be surrendered. One who accepts the benefits of the will must adopt the whole contents so far as it concerns him, and renounce every right inconsistent with it. *Dunn* v. *Vinyard,* Tex. Comm. App., 1923, 251 S.W. 1043; *Dakan* v. *Dakan,* Tex., 1935, 83 S.W. 2d 620; *White* v. *Hebberd,* Tex. Civ. App., 1936, 89 S.W. 2d 482; *State* v. *Jones,* Tex. Civ. App., 1927, 290 S.W. 244; 44 Texas Jurisprudence 285.

Because of a long history of cases stoutly supporting a

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[14] Rogers v. Trevathan, 1887, 67 Tex. 406; Moss v. Helsley, 1883, 60 Tex. 426; Brown v. Pridgen, 1882, 56 Tex. 124.

[15] Hansen v. Blackmon, 1942, Tex. Civ. App., 169 S.W. 2d 955, aff'd, 1943, 140 Tex. 536, 169 S.W. 2d 962.

[16] Lang v. Commissioner, 1938, 304 U.S. 264, 58 S.W. 880, 82 L. Ed. 1331; Commissioner v. Cadwallader, 9 Cir., 1938, 99 F. 2d 523; Wardell v. Blum, 9 Cir., 1921, 276 F. 226, cert. denied 258 U.S. 617.

wife's vested ownership of half the community, Texas courts are loath to divest a widow of her share of the community on loose inferences. A study of the cases shows five major obstacles standing in the way of an election.

(1) *A presumption exists that a testator intends to dispose of his property only.* In *Whaley* v. *Quillin*, Tex. Civ. App., 1941, 153 S.W. 2d 969, involving a will in which the testator left his residuary estate in trust for his wife, the court held that the will disposed of the testator's share only; that "the law presumes that no man will attempt to dispose of another's property through the instrumentality of a will . . . the law will deprive no man of his property by conjecture". See also the leading cases of *Avery* v. *Johnson*, Tex. Sup. Ct. 1917, 192 S.W. 542 and *Ellis* v. *Scott*, Tex. Civ. App., 1933, 58 S.W. 2d 194.

(2) *Only where the testator's intention is shown by clear and unequivocal language is a husband's will construed to devise his wife's property.* *Pope* v. *Pope*, Tex. Civ. App., 1943, 175 S.W. 2d 289. "In order that the necessity of an election shall take place, the testator must affect to dispose of property which is not his own, and also make a gift of his own property." *McFarland* v. *Campbell*, 5 Cir., 1954, 213 F. 2d 85. See also *Couts* v. *Holland*, Tex. Civ. App., 1908, 107 S.W. 913; *Haby* v. *Fuos*, Tex. Civ. App., 1894, 25 S.W. 1121; *Edds* v. *Edds*, Tex. Civ. App., 1926, 282 S.W. 638; *Gibony* v. *Hutcheson*, Tex. Civ. App., 1899, 50 S.W. 648.

(3) *The language of the will must be susceptible of no other construction.* ". . . [The law] deprives no man of his property merely by conjecture. For a will to be given the effect of an attempted disposition of property not owned by the testator, it is required that the language of the will conclusively evidence such a purpose. In such cases it is not sufficient that the will may be construed as revealing such an intention. It is necessary that it be open to no other

construction." *Avery* v. *Johnson*, Tex. Sup Ct., 1917, 192 S.W. 542, 544. If a will is ambiguous as to whether a testator attempted to dispose of both halves of the community, only the testator's half passes under his will. "[I]f this will should be construed to be ambiguous on the question as to whether the testator intended to bequeath the entire community estate, or merely the interest he owned therein, then the law furnishes a solution by requiring that it be given the construction that only the property owned by the testator was intended to pass thereunder." *Schelb* v. *Sparenburg*, Tex. Sup. Ct., 1939, 124 S.W. 2d 322. See also *Gulf C. & S. F.R. Co.* v. *Brandenberg*, Tex. Civ. App., 1914, 167 S.W. 170.

(4) *Use of the first person singular pronoun shows an intention to dispose of the testator's property only.* In *Haley* v. *Gatewood*, 74 Tex. 281, 12 S.W. 25, the testator used the language, "I will and bequeath all the estate I now own and possess". The Texas Supreme Court held: "We do not think this language indicates an intention on the part of the testator to dispose of any part which he did not own or possess." In *Sailor* v. *Furche*, Tex. Comm. App., 1930, 22 S.W. 2d 1065, the same result was reached where the testator made a testamentary disposition to his wife of "all property, real, personal, and mixed, of which I may die seized and possessed, wherever situated". A devise of "my" property is construed as referring only to the testator's interest in the community property. *Sauvage* v. *Wauhop*, Tex. Civ. App., 1912, 143 S.W. 259.

(5) *Finally, the will must give some benefit to replace the property surrendered by the election: Smith* v. *Butler*, Tex. Sup. Ct., 1892, 19 S.W. 1083; *Packard* v. *Meranda*, Tex. Civ. App., 1912, 146 S.W. 211.

It is in the light of this consistent reluctance of Texas

courts to base an election on uncertain inferences that Daniel's will must be examined.

The critical language in Daniel's will creating the testamentary trust provides:

> "Fifth: I give, devise and bequeath all of the rest, residue and remainder of the property, both real and personal, *which I shall own or to which I may be entitled at the time of my death* (hereinafter referred to as *my* 'residuary estate') by *my* Trustee of the residuary trust created hereby, in trust . . ."
>
> "Tenth: In the administration of *my* estate, *my* executor shall have power . . ."
>
> "Eleventh: In the administration of any trust created hereby *my* Trustees shall have power . . ."
>
> "Twelfth: In the administration of *my* estate . . ."

Under the law of Texas, the only property Daniel owned or to which he was entitled at the time of his death was his half of the community. The care with which Daniel defined such property as *his residuary estate,* limiting it to the property to which *he* was entitled, seems to negate the construction that he intended to dispose of property he did not own. The studied absence of reference to the community or to Marie's share of the community seems to contradict the contention that Daniel disposed of the entire community, including Marie's half. Thus, (a) the unambiguous definition of the residuary estate as restricted to property which Daniel owned or was entitled to at the time of his death, (b) the use of the first person singular pronoun, and (c) the complete absence of any dispositive language relating to Marie's share indicate that Daniel did not purport to include Marie's half of the community in the testamentary trust of his residuary estate.

If no intention to dispose of Marie's property can be found in Paragraph Five, quoted above, then it is difficult to read it into the will, since that paragraph is the only one that is dispositive of the residuary estate. The Commissioner relies however on Paragraph Seventeen, that is explanatory rather than dispositive. The paragraph reads:

> "Seventeenth: The provisions herein contained for the benefit of my wife are in lieu of dower and any or all other provisions statutory or otherwise for her benefit as my widow."

This provision is meaningless in a community property state such as Texas. There is no dower in Texas. And, a wife's ownership of half the community is not analogous to the common-law inchoate right of dower. One is a present, vested ownership. The other is a mere expectancy that may be snuffed out. In Texas a wife shares in community property not as a widow, but as a wife, *ipso jure*, the moment property is acquired. Community property has nothing to do with benefits for widows. Marie, under Texas law, therefore, had no rights of the character referred to in Paragraph Seventeen, as Judge Murdock pointed out in his dissent to the Tax Court holding.[17]

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[17] "Murdock, J., dissenting: . . . Her husband had no legal right to dispose of her property by his will, and it seems wrong to conclude as a matter of law that he did so under the terms of paragraph FIFTH of his will. I do not understand how he could impose binding conditions in his will dependent solely upon what Marie would do with her own. Paragraph SEVENTEENTH of the will imposed no real penalty upon Marie had she chosen to consider that her share of the community property following the death of her husband was not included in his testamentary trust. It does not appear that under the laws of Texas she had any dower rights or other rights, as the widow of her deceased husband, of the kind mentioned in paragraph SEVENTEENTH. Certainly she did not acquire her right to one-half of the community property as widow of her deceased husband. She had

Since there is no language in the will to give aid and comfort to his view, the Commissioner is compelled to resort to speculation based on circumstances outside of the will. He contends that the husband's customary handling of all business matters and the wife's inexperience and lack of knowledge justify the conclusion that Daniel must have intended to dispose of all their property (her property included) by giving her a life estate with a competent trustee in charge for her protection. These circumstances exist in most marriages. If an election exists because a husband is experienced and a wife inexperienced in business, then a great majority of all wills put the wife to an election. Such speculation strikes us as a shaky basis for divesting a wife of her ownership of half the community.

If we must speculate, we would give considerable weight to the fact that Daniel was married and lived under Texas community property law for twenty-six years. He was a man of affairs, a man of property, head of Continental Oil Company. In the last six years of his life, something like a state of war existed between the community property states and the noncommunity property states. Taxpayers of means were well aware of the tax involvements inherent in community property. It is difficult to believe that Daniel would not have stated his intentions clearly — if he had intended to require Marie to give up her half of the com-

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that right during their marriage. Had she accepted the FIFTH paragraph of his will as applying to the property owned by her husband at the time of his death but not as applying to her property at that time, she could have received the life estate in the property which he properly and legally placed in his testamentary trust and her transfer to the same trust of property which belonged to her at the death of her husband was not consideration for the life estate which her husband gave her in his property."

munity as a condition to receiving his bounty.[18] We think also that it is not without significance that when Texas attorneys, familiar with community property law, entered the case (on appeal), they reacted allergically to the contention that the will purported to put Marie to an election, or that she had made an election.[19]

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[18] Contrast the language of Daniel's will with the language of Siegel's will: "The provisions made in this my Last Will and Testament for my beloved Wife, Mildred Irene Siegel, are in lieu of her community rights and interest, and if she elects to take her community interest, in lieu of taking under this my Last Will and Testament, then the bequests made to her in Paragraph Three hereof shall be of no force and effect and the real and personal property so bequeathed shall become a part of the rest, residue and remainder of my said estate to be distributed to my said trustees, and like wise subdivision (a) of paragraph Seven shall be of no force and effect and she shall take nothing as a beneficiary under said trust." Comm. of Int. Rev. v. Siegel, 9 Cir., 1958, 250 F. 2d 339.

[19] The Commissioner cites two extreme cases, Delevan v. Thom, Tex. Civ. App., 1951, 244 S.W. 2d 551 and Baldwin v. Baldwin, 1940, 134 Tex. 428, 135 S.W. 2d 92. In Delevan v. Thom the record showed that the widow was of unsound mind when her husband died and was incapable of speech or of voluntary movement. This condition had existed for some time prior to her husband's death. The will was made five months before the testator died. These circumstances and the fact that the court found four or five expressions in the will indicating the testator's intention to dispose of his wife's share of the community, induced the Court to hold that the will put the widow to an election. In Baldwin v. Baldwin the testator stated that all of the property owned by his wife and himself was community, except her separate property, and he expressly recognized that his wife shared in the estate. The testator left several specific legacies of community property to third persons, showing a clear intention to dispose of his wife's share along with his. The will contained an election provision. All of this, plus fifteen years of administration by the wife as executor, induced the Court to hold that there was an election. Delevan v. Thom and Baldwin v. Baldwin may be distinguished or explained; in any event they are exceptional cases and against the trend. In each case the court starts its opinion by bowing in the direction of the line of decisions holding that in determining whether the will disposes of the beneficiary's property, the rule is that the will does not so dispose of the property unless it is "open to no other construction."

B. If it might be said that the will puts Marie to an election, the record does not show that Marie did in fact elect to take under the will. Chase, the Trustee and Ancillary Executor, in its complaint filed in the Tax Court in 1953, *five years after Daniel's death,* alleged that "no determination has yet been made as to whether or not the said Marie Elizabeth Moran has elected to take under the will". If anyone should know, Chase should know. Perlitz, the Executor, in his brief testimony, said that Marie had never asked "whether she had any right to move against the trust" or "against the will"; and that he had never "volunteer[ed] that she might have any right to bring suit against the trustees".

In the absence of any showing in the record that Marie had sufficient knowledge of her rights to make a conscious choice, it can hardly be said that she made an election. "In the absence of statutory regulation, it may be generally said that two things are necessary in order that acts relied upon will amount to an election: First, the party must have had knowledge of his rights; that is, he must have had knowledge of the condition and extent of the estate, and of his duty to choose between the inconsistent rights; second, that he intended to elect, as shown by his words and acts, viewed in the light of all the circumstances." *Dunn* v. *Vinyard,* Tex. Comm. App., 1923, 251 S.W. 1043.

In *Rippy* v. *Rippy,* Tex. Civ. App., 1932, 49 S.W. 2d 494, a widow sued the executor of her husband's estate for her one-half community property share. The defense was that her husband's will had put her to an election, and that by receiving money under the will she had made an election. The court held for the wife stating that: "But, if the terms

of the will required appellee to elect to take thereunder, the evidence is undisputed that she had no knowledge of her rights in the premises, nor that she was required *to choose between inconsistent rights* . . . . she accepted the $500 without any knowledge that she was required to choose between two inconsistent rights."

In this case, as in *Rippy* v. *Rippy* and in *Dunn* v. *Vinyard*, there is no showing, so far as the record goes, that Marie had knowledge of her rights, nor that she understood that it might be said she was to choose between two inconsistent rights. There is no element of estoppel here. No one was misled to his prejudice. Marie received no benefits to which she was not entitled—on the assumption that Daniel created a trust of his half. The full income was hers: half in her own right for her share of the community, half as income beneficiary under the trust. She was entitled, therefore, to receive the full income from the trust.

The record is barren of any evidence to show intention by Marie to create a trust by allowing Chase to have possession of her share of the community. In community property states a widow may leave her share of community with the executor, usually a bank that serves also as trustee under a testamentary trust created by the deceased husband. The reasons are two-fold: (1) to continue the administration of the former community as a whole and (2) to give a widow the benefit of a bank's custodial and managerial services. There was no necessity therefore, as in *Delevan* v. *Thom*, Tex. Civ. App., 1951, 244 S.W. 2d 551, that all of the Moran community be included in a trust; and there was nothing unusual about Marie receiving all of the income. It seems to us that, on the record, all that can be said of Chase's possession of Marie's share of the community is that it was held by the bank as agent or custodian. If it could be said that

Marie created a trust under Texas law, the trust would be revocable (and therefore not subject to a gift tax.)[20]

Weighing the language of the will and all the circumstances, we agree with the taxpayer that the will did not put Marie to an election and she made no effort to elect. Accordingly, Marie made no taxable transfer of her share of the community. It is still in her taxable estate. If she chooses to follow her husband's example, she may do so now by gift or by will. This determination gives full effect to the community property law of Texas, is consistent with the gift tax law, and is in the interest of justice; a wife is not divested of ownership of her share of the community by a loose construction of a will.

VI. The Insurance Trust.

The Commissioner's position is that on Daniel's death Marie made a taxable gift of one-half of the value of the proceeds of the insurance policies less the value of a life estate in that half. Chase, the trustee, contends (on appeal) that, although Daniel could revoke the trust and change beneficiaries, Marie could not, and as to her the trust was complete and irrevocable in 1928 when it was created, and therefore there is no tax. The Tax Court held that there was no tax. Under Texas decisions, as the Tax Court construed them, since a surviving wife has no community property interest in the *proceeds* of insurance payable to a

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[20] Tex. Rev. Civ. Stat. Ann. Art. 7425b-41: "Every trust shall be revocable by the trustor during his lifetime, unless expressly made irrevocable by the terms of the instrument creating the same or by a supplement or amendment thereto." [Acts 1943, 48th Leg., p. 232, ch. 148 § 41.]

named beneficiary,[21] Marie could make no taxable gift involving any part of the proceeds. We agree with the Commissioner.

If the decision of the Tax Court is upheld, consistency would require that the entire proceeds of insurance policies be included in a husband's estate, notwithstanding his ownership of only half of the marital community. The results reached by the Tax Court (A) violate principles of Texas community property law; (B) are contrary to the pre-1942 tax cases (now revitalized by the Revenue Act of 1948), and (C) frustrate the national policy of tax equalization expressed in the Revenue Act of 1948 and interpreted in the regulations carrying out that policy.

A. The holding of the Tax Court is not surprising in view of the apparent inconsistency of the Texas cases and the professed inability of some authorities to find a

[21] The Tax Court held: "However, the law of Texas appears to be that where the marriage is terminated by the death of the husband, the proceeds of the policies are payable to the named beneficiary and the wife does not have any community property interest that can be asserted against such proceeds. Cf. Jones v. Jones, 146 S.W. 265, 269 (Tex. Civ. App.); Rowlett v. Mitchell, 52 Tex. Civ. App. at p. 592, 114 S.W. at p. 847; Martin v. McAllister, 94 Tex. 567, 569, 63 S.W. 624, 625. Furthermore, it has been held that upon the death of the insured husband any cash surrender value the policy may have had during his lifetime lapses, and no claim based upon a supposed interest in such cash surrender value can succeed. Volunteer Life Ins. Co. v. Hardin, 145 Tex. 245, 197 S.W. 2d 105; San Jacinto Bldg. v. Brown, 79 S.W. 2d 164 (Tex. Civ. App.). The distinction may appear to be a bit unusual, but we must take the law of Texas as we find it. Until the Texas courts indicate otherwise, we must assume that the foregoing cases correctly establish the law of Texas, and they *appear* to hold that the wife has no community property interest in the proceeds of the policies upon the husband's death."

rational basis for reconciling the cases.[22] We have no desire to rush in where Texans fear to tread. If, however, there is a rational principle running through the Texas cases, we must find it and apply it: local law determines property rights.[22a] We believe that a close study of the Texas cases shows that the inconsistency is only apparent, not real, and that there is a discoverable touchstone for applying orthodox community property principles to insurance. The

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[22] William O. Huie, Professor of Law of the University of Texas, a recognized authority on the community property system of Texas, reviewed the cases in 1939-1940. Community Property Law as Applied to Life Insurance, 17 Tex. L. Rev. 121 (1939), 18 Tex. L. Rev. 121 (1940). In a recent paper on the same subject he stated: "I was unable at that time [1939-1940] to fit all of the Texas cases into any rational, consistent scheme, and that is still the situation today. The primary difficulty has been a fundamental inconsistency in the Texas cases as to the concepts to be applied, an inconsistency that began long ago and has persisted with stubborn tenacity. It can be described as *a difference of opinion over whether or not a life insurance policy is property.*" Texas Institutes, Business and Family Planning, p. 119; Proc. 5th Annual Taxation Conference, (1957). See also Stephens, Life Insurance and Community Property in Texas — Revised, 10 S.W. L. J. 343 (1953); Notes, 35 Tex. L. J. Rev. 449 (1957), 10 S.W. L. J. 326 (1956). John Paul Jackson, who had an active part in working out the tax equalization program in 1948, that attempts to harmonize community property concepts of insurance with the tax laws, does not go so far. "While the cases generally have regarded the insurance policies and the avails thereof as but another species of community property to be governed by the usual community property rules, dicta in some of the cases have rather suggested that life insurance is sui juris, that policies of life insurance are not property in the community property sense, and that the life insurance laws are a gloss upon the community laws." Jackson, Community Property and Taxation, 12 S.W. L. J. 1, 40 (1958).

[22a] See Paul, Selected Studies in Federal Taxation (2d. ser. 1938); Cahn, Local Law in Federal Taxation, 52 Cole L. J. 799 (1943); Lang v. Commissioner, 1938, 304 U.S. 264, 58 S. Ct. 880, 82 L. Ed. 1331. But from 1942 to 1948 state property law was a mirage, as far as solice for taxpayers is concerned.

touchstone is the distinction between *policy-rights* and *proceed-rights*.[23]

Our study of the Texas cases indicates that the doubt that has arisen as to whether insurance is property subject to ownership by the community has been caused by courts failing to *say* that they distinguish between *policy-rights* and *proceeds-rights*. Texas courts consistently make this distinction in their holdings. And consistently recognize that policy-rights are a property asset of the community, and proceeds-rights are property of the named beneficiary

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[23] "This difficulty stems in large part from the failure to distinguish between rights in the policy during life and rights in the proceeds following the insured's death; . . . A further source of confusion arises from the fact that although occasionally the individual may possess all of the rights in the policy as well as in its proceeds, these rights may be, and usually are, divided in various combinations." Thurman, Federal Estate and Gift Taxation of Community Property Insurance, 9 Stan. L. Rev. 239, (1957). See also, Eichenbaum, Estate Taxation of Insurance Proceeds in Community Property States, 1952 Tulane Tax Institute 251. A thorough analysis of the nature of the community's ownership of insurance and the distinction between policy-rights and proceeds-rights may be found in Benjamin and Pigman's Federal Estate and Gift Taxation of Louisiana Life Insurance, 28 Tul. L. Rev. 75, 243 (1953, 1954). After the submission of the substance of this article in the form of a memorandum to the Treasury Department, the Bureau issued Rev. Rul. 48, 1953-1 Cum. Bull. 392 reversing its position on insurance and holding that "[i]t is the position of the Bureau that, under the laws of Louisiana and Texas, a gift by the wife of one-half of the policy proceeds becomes absolute, for Federal gift tax purposes, upon the death of the husband, unless he purchased the policy with intent to defraud the wife, since at that time the community is dissolved, the authority of the husband as statutory manager of the community is ended, the policy matures, and the wife's interest therein is terminated; whereas, during the existence of the marital community any revocable transfer of rights is necessarily incomplete since the husband, acting for himself and as agent of his wife, may change the beneficiary, surrender the policy for cash, or exercise other legal incidents of ownership in accordance with the terms of the policy or the laws of the State."

(after maturity of the policy) — however often one encounters the language "insurance is not property" in cases involving contests over proceeds.

Policy-rights include the whole bundle of incidents of ownership of property in a policy — all the rights except the right to the proceeds. This bundle includes all "the economic benefits of the insurance, the cash surrender value, the power to change the beneficiary, the power to surrender or cancel the policy, the power to assign the policy or revoke an assignment, the power to pledge the policy for a loan, the power to obtain from the insurer a loan against the surrender value of the policy".[24] These are property rights, as any lawyer or business man knows. They are owned by the marital community when the community pays for the insurance and there is a revocable designation of beneficiary. The right to insurance proceeds is also property just as any other contractual right to money is property, but it is in the beneficiary by a contract which the husband as manager of the community can legally make. If the right to change the beneficiary is reserved, the beneficiary's proceeds-rights are inchoate until the death of the insured, when these proceeds-rights vest by virtue of the terms of the contract; but in this sense only can it be said that insurance (*i. e.*, the right to the proceeds) is not property subject to the laws of descent, heirship, or community property.

No one familiar with the workings of the community property system should be surprised that Texas courts hold that the wife has no interest in insurance proceeds received by a third party beneficiary. *In the absence of fraud, the wife has no interest in any community property a third person has received by sale or donation,* even though half of the property transferred was the wife's. The wife's lack

[24] Benjamin and Pigman Federal Estate and Gift Taxation of Louisiana Life Insurance, 28 Tul. L. Rev., 243, 247 (1954).

of interest in the proceeds, however, is not inconsistent with the view that the *community* effects a gift of the proceeds to a third person beneficiary.

There is not one case in Texas that fails to recognize, *in result*, that insurance *is* property: when the policy-rights are at issue or, if proceeds-rights are at issue, when the contest is between the surviving spouse and a third party beneficiary and there is no fraud.[25] There is smog only when there is a contest between the surviving spouse or her heirs, and the insured or his heirs and the practical effect of applying these principles would be to allow the husband to augment his separate estate at the expense of the community. That factual situation is not present in this case.

The Tax Court recognized that up to the time of Daniel's death the insurance (at least, the cash surrender value) was community property in which the wife had a vested interest. The Tax Court and Chase, the trustee, did not

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[25] "If a third party is named beneficiary, the usual rules relating to gifts of community property obtain. In Texas, unlike the civil law in some jurisdictions, the husband as manager of the community may make limited gifts of community property. Such gifts, however, are subject to the rule that the transfer must not be in fraud of the wife's community rights. Here the rule is not an absolute one, but relative, being largely a matter of degree and substantiality. If the gift is large in relation to the size of the community, and particularly, if made to one not an intimate member of the family group, the wife may, as to one-half, succeed in having it set aside. These rules would apply to gifts of life insurance. If the policy is assigned outright to a child or other third party and is not in fraud of the wife's rights, husband and wife each have made a gift of one-half. If a third party is named beneficiary and the right to change beneficiaries is retained, the gift is incomplete until the death of the insured, at which time the rights of the beneficiary become vested and the spouses at that time have completed their gift. But if either the assignment of the policy or the beneficiary designation is in fraud of the wife's rights, she may recover half of the policy proceeds." John Paul Jackson, Community Property and Federal Taxes, 12 S.W. L. J. 1, (1958).

recognize, however, that when Daniel took out the insurance and created the insurance trust, he acted and could act only as manager of the community. The right of revocation was not in Daniel individually, nor was the trust irrevocable only as to Marie's half of the community. Daniel held the power of revocation as agent or manager of the community. When he died without having exercised that power, the insurance became payable and the trust became irrevocable. His death operated to effect a taxable transfer from the community (husband and wife), rather than to preclude a taxable transfer from Marie, as the tax court seemed to think.

A review of the jurisprudence shows that the Texas courts do in fact treat insurance as property, distinguishing between policy-rights and proceeds-rights. Invariably, they treat policy-rights in insurance as property that is a community asset. Just as invariably, they hold that, in the absence of fraud, the wife has no community interest in the proceeds of insurance payable to a third party beneficiary.

The first case to deal with the problem is the frequently cited case of *Martin* v. *Moran*, Tex. Civ. App., 1895, 32 S.W. 901. The husband insured his life *for the benefit of his own estate*, paying premiums with community funds. The Court held that the wife had a half interest in the proceeds. The Court accepted the proposition that insurance was property and analogized an insurance policy to a promissory note taken during the marriage for a loan of community funds and paid after the death of the husband. The analogy is not sound as to insurance proceeds payable to a third party beneficiary, since the promissory note is really payable to the community. The analogy is sound as to insurance payable to the husband's estate, only if he is regarded as acting as agent for the community in designating his estate as beneficiary. The result, however, is sound; not because insur-

ance *proceeds* are a community asset, but because the Court in that case found it was fraudulent for the husband to augment his separate estate at the expense of the community. The Court said: "The husband can give his interest in the community to another, but he cannot give his wife's interest in the community to himself."

In the converse of the situation, where an insurance policy is payable to the *wife,* Texas law is clear that the proceeds are *her* separate property. *San Jacinto Bldg., Inc.* v. *Brenn,* Tex. Civ. App., 1935, 79 SW. 2d 164; *Evans* v. *Opperman,* 1890, 78 Tex. 293, 13 S.W. 312; *Davis* v. *Magnolia Petroleum Co.,* 134 Tex. 201, 134 S.W. 2d 1042; *Blackmon* v. *Hansen,* 1943, 140 Tex. 536, 169 S.W. 2d 962. That is because the husband is manager of the community, she is not; he can make a gift of community to her, but not to himself. These cases and *Martin* v. *Moran,* too, are good community property law.

Martin v *McAllister,* 1901, 94 Tex. 567, 63 S.W. 624, has been criticized as a horrible example of what happens when insurance proceeds are not treated as community assets. In that case, the husband took out a policy on the wife's life, *named himself as beneficiary,* and paid the premiums with community funds. The Supreme Court of Texas held that the wife's heirs were not entitled to share in the proceeds: "The right to the proceeds of the policy . . . rests upon the principle . . . that . . . the proceeds of the policy belong to the person named as payee and it becomes property upon the contingency of the death of the insured". *Martin* v. *Moran* was not cited, but the holding is not necessarily inconsistent, since the Court could "see no ground *in the facts of this case* to impeach the action of the husband as fraudulent" toward his wife. Since the proceeds-rights "could not become the property of the husband or wife during the lifetime of both of them, it cannot be held to be community, and is therefore the separate property of the

one to whom it is made payable". There is confusing language in the opinion, such as the statement that "a policy of insurance is not a piece of property; it is the evidence of a contract".[26] But the Court's thinking clearly centered about the proceeds-rights. Up to the moment of transfer, the policy-rights are community assets; after the transfer, the wife has no interest. On the assumption that there was no fraud, the case is in line with the principle — stronger in Texas than in most community property states — that the husband can dispose freely of community assets.

This is brought out clearly in *Rowlett* v. *Mitchell,* Tex. Civ. App., 1908, 114 S.W. 845, in which community funds were used to pay premiums on a policy payable to *third persons,* the husband's children by his first marriage.[27] The policy was taken out before the second marriage. In a contest between the beneficiaries and the second wife the court held for the beneficiaries. "The right of the husband to dispose of the community estate except for the purpose of defrauding his wife is an absolute one . . . he may expend their joint estate ever so unwisely, may squander it in 'riotous living', or may give it away."

The next case, *Jones* v. *Jones,* Tex. Civ. App., 1912, 146 S.W. 265, also involved the question whether the husband had acted in fraud of his wife. Shortly before his death

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[26] This quotation comes from an early Louisiana case, Succession of Hearing, La. S. Ct., 1874, 26 La. Ann. 326.

[27] In Kemp v. Metropolitan Life, 5 Cir., 1953, 205 F. 2d 857 this Court held that there could be *constructive* fraud where a husband named his sisters as beneficiaries. This Court said: "It is now settled that a policy of life insurance is regarded in Texas as property." In Kemp v. Metropolitan Life, 5 Cir., 1955, 220 F. 2d 952 we held that there was no fraud on the wife's rights on a finding that the husband had recognized a duty to support his sisters and had acted fairly toward his wife, even though the proceeds amounted to more than half of the community estate. See also Aaron v. Aaron, Tex. Civ. App., 1943, 173 S.W. 2d 310.

the insured substituted his father for his wife as beneficiary on a policy purchased with community funds. The Court relying on *Rowlett* v. *Mitchell* and *Martin* v. *McAllister* held for the beneficiary on the ground that the evidence was insufficient to show fraud. The Court said that "an insurance policy is not property". But, as in *Rowlett* v. *Mitchell*, the holding involved a contest with a third party beneficiary over proceeds.

These important early cases were on proceeds-rights. *Whiteselle* v. *Northwestern Mutual Life Ins. Co.*, Tex. Comm. App., 1920, 221 S.W. 575, involved a contest over policy-rights. Here, there was a divorce and the issues were whether the community had a claim for reimbursement for premiums paid and whether the cash surrender value was an asset of the community. The Court rejected the wife's claims. Texas courts have now reversed their position on cash surrender. In *San Jacinto Bldg.* v. *Brown*, Tex. Civ. App., 1935, 79 S.W. 2d 164, the wife was the beneficiary, and a creditor of the husband was attempting to reach community property. The Court held that the cash surrender value was a community asset, but it was consumed in the payment of the proceeds to the wife; that the proceeds were the separate property of the wife. *Russell* v. *Russell*, Tex. Civ. App., 1935, 79 S.W. 2d 639, gave full recognition to this characteristic of insurance in holding that upon divorce a wife is entitled to one-half the cash surrender value of a policy purchased with community funds. This result was approved in *Locke* v. *Locke*, Tex. Civ. App., 1940, 143 S.W. 2d 637, another divorce case, in which the court specifically stated that the cash surrender value of the policy is a community asset, and that the wife has a vested one-half interest in this asset. This was followed in *Berdoll* v. *Berdoll*, Tex. Civ. App., 1940, 145 S.W. 2d 227, and *Womack* v. *Womack*, 1943, 141 Tex. 299, 172 S.W. 2d 307.

Womack v. *Womack* is a direct recognition by the Texas Supreme Court that the policy rights in an insurance policy constitute community property. This was a divorce case involving policies on the lives of both spouses. The Court stated: "The courts of this state hold that the cash surrender value of a policy is property, and may be considered and treated as community property." *Whiteselle* was expressly overruled. The Court based its holding on a broad construction of property, extending to "every species of valuable right and interest"; and on the intention of the Texas legislature, "to give the term community property a broader meaning than it was originally given [in Article 4619, Vernon's Annotated Civ. Stat.]". The Court pointed out that "many of the modern decisions hold that a life insurance policy is property".

Thompson v. *Calvert*, Tex. Civ. App., 1957, 301 S.W. 2d 496, carried Womack to its logical conclusion. That case, like the instant case, involved policies on the husband's life taken out during marriage and paid for with community funds, the insured retaining the right to change the beneficiary. On the wife's death, the Court, approving a ruling of the Texas Attorney General in 1949, treated the policy-rights as a community asset and held that one-half of the cash surrender value of the policies at the time of the wife's death should be included in the wife's estate for inheritance tax purposes.[28]

Blackmon v. *Hansen*, 1943, 140 Tex. 536, 169 S.W. 2d 962, dealt with proceeds. In that case the Texas Supreme Court

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[28] On the authority of Thompson v. Calvert and Womack v. Womack, the Attorney-General of Texas ruled recently that: where a wife willed the residue of her estate to three named beneficiaries, for inheritance tax purposes decedent's half of the cash surrender value of certain insurance on the surviving husband's life passed to the beneficiaries. Opinion No. WW-446, June 6, 1958, CCH Inheritance Tax Rep. 1958, para. 18, 786.

held that where insurance on a husband's life, payable to the wife, was paid for with community funds, one-half of the proceeds should be included in the husband's gross estate in calculating the State Inheritance Tax. This is on the community property principle that the husband is responsible for only half of the transfer (transformation) of policy-rights into proceeds-rights; the other half comes from the wife herself. Had the insurance been payable to the husband's estate, still only half of the proceeds could have been included in *his* taxable estate. The Court followed *Lang* v. *Commissioner,* 1938, 304 U.S. 264, 58 S. Ct. 880, 82 L. Ed. 1331, in which the United States Supreme Court reached the same conclusion based not on the wife's ownership of the proceeds but on (1) her payment of half of the premiums and (2) her husband's possession of the incidents of ownership as agent of the community.

Blackmon v. *Hansen* and *Thompson* v. *Calvert* establish the Texas rule for taxation of insurance on the life of a husband when the premiums are paid with community funds and the insured retains the right to change the beneficiary. That is the basic factual situation in the instant case. Since both the state and federal laws for estate-inheritance and gift tax purposes "tax the transfer of a present vested interest, state cases interpreting the Texas Inheritance Tax Law should be decisive for the Federal Court in applying state law." Morrison, Life Insurance—Tax Aspects, 5 Texas Institutes, p. 139 (1957). Applying *Blackmon* v. *Hansen* to federal estate and gift taxes applicable to insurance payable to a third person, one half of the proceeds are includible in the husband's estate and one-half are a taxable gift to the wife.

Volunteer State Life Ins. Co. v. *Hardin,* 1946, 145 Tex. 245, 197 S.W. 2d 105 (1946) points up the distinction we are

seeking to make. There the insured husband named his two sisters as beneficiaries. On the death, first of the wife, and later of the husband, the wife's son and sole heir asserted a claim to share in the proceeds to the extent of one-half of the cash surrender value at the date of his mother's death. The court held that neither the community nor the wife had a vested right to share in the proceeds of the policies. *Martin* v. *McAllister* was quoted with approval. As Professor Huie points out: ". . . the decision in the *Hardin* case was basically sound. The problem before the court was how far the husband could go in making gifts of community property to third persons. . . . [The] result seems in line with the better view in cases involving gifts of third persons . . . Such gifts, whether by means of life insurance or otherwise, are sustained if they are not deemed a fraud on the wife's community rights."[29]

In other words, the Texas courts *do* treat insurance as property; and, they are "basically sound"—as long as they hold that the husband may give to anybody but his estate. That is the basic position of critics of the Texas courts.

Sherman v. *Roe*, 1953, 153 Tex. 1, 262 S.W. 2d 893, concerned the death of a husband and wife in an airplane crash, before enactment of the Texas Simultaneous Death Act. Insurance on the husband's life was taken out before his marriage and paid for with separate funds until his marriage. The proceeds were payable to the wife if she survived him, otherwise the proceeds were payable to his estate. It could not be determined who died first. The Court cut the Gordian knot by awarding the proceeds equally to the estates of husband and wife on the theory that the proceeds

[29] Huie, Community Property and Life Insurance U. of Texas Institute, Proc. 5th Ann. Tax Conf. (1957), pp. 118, 134.

were community. The Court relied on the statutory presumption in Article 4619 that "all the effects which the husband and wife possess at the time the marriage may be dissolved shall be regarded as common effects or gains unless the contrary be satisfactorily proved." The opinion shows the dialectic difficulty courts in community property states have in handling insurance. The Court denied that "the certificate was community property and [that] consequently the proceeds must be community property." Yet in asserting that the proceeds should be regarded as part of the "effects possessed" at the dissolution of the marriage, the court necessarily treated the contract right to the proceeds as property in existence at the dissolution of the marriage, although maturing on the death of the insured.

Warthan v. *Haynes*, Tex., 1956, 288 S.W. 2d 281, termed "the ultimate bombshell",[30] has been widely discussed and criticized in Texas.[31] In that case husband and wife were killed in an automobile accident. Unlike *Sherman* v. *Roe* it was established that the wife died some fifteen to thirty minutes before her husband. There were three insurance policies on the husband, one taken out before marriage. The wife was the primary beneficiary and the husband's estate the alternate beneficiary in two of the policies; the third had no provision for an alternate beneficiary. The contest was between the respective administrators of the estates of the husband and wife. The majority of the Court

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[30] Stephens, Life Insurance and Community Property in Texas—Revised, 10 S.W. L. J. 343, 355 (1956). See generally U. of Texas Institute, 5th Ann. Taxation Conference, 1957.

[31] For example: "The rationale rests on the court's refusal to recognize the property aspects of life insurance . . . In seeking simplicity, the court seems only to have perpetuated the logical inconsistency of labelling insurance as property for some purposes but not for others." Note, 35 Tex. L. Rev. 449 (1957).

awarded the proceeds of all three policies to the husband's separate estate, without any right to reimbursement to the community for funds used to pay premiums.[32] The Court relied heavily on *Volunteer State Life Insurance* v. *Hardin* in holding that the named beneficiary is entitled to the proceeds where there is no fraud on the wife; limited *Sherman* v. *Roe* to its peculiar facts; and reaffirmed *Martin* v. *McAllister; Martin* v. *Moran* was distinguished — properly, it seems to us — on the ground that "under certain circumstances" a husband's making a policy payable to his estate may be a fraud on his wife; here with the wife named as first beneficiary, there was no question of fraud. The opinion specifically recognizes that for tax purposes only, half the proceeds would be includible in the husband's estate under state inheritance tax laws, citing *Blackmon* v. *Hansen*, but pointed out that it was clearly established in Texas that proceeds payable to the wife were *her* separate

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[32] Judge Garwood wrote a powerful dissent, contending that insurance *is* property. He argued strongly that the proceeds of the policies taken out during the marriage are community property and should go to the community estate. But he reaches the same conclusion that Professor Huie reaches and we reach, that insurance payable to a third person "may in a proper case amount to no more than legitimate gifts of community property." He is careful to say that "this idea is not inconsistent with the idea that the community has a real interest in the policy [rights]. Certainly the husband [as manager or trustee] [for the community] has a real interest." What offends Judge Garwood, and properly, is that the husband may use his position at trustee to augment his separate estate to the detriment of the community in cases where fraud may be difficult to find or may be absent. As Judge Garwood puts it: "[T]he community estate furnished all of the premiums . . . the Court holds the full proceeds to be separate estate of the husband . . . These sums of money, which, by every decision classic in this and other community property states, are community property become the separate estate of the assured husband merely because the contract happens to be one of life insurance."

property based upon the husband's right to make a gift.[33]

With due deference, it seems to us that the Texas courts were less enmeshed in conflicting concepts than some of their critics. The decision recognizes that insurance is community property as to policy rights, but that the transfer or conversion of those rights into proceeds-rights by a contract entered into by the husband *in the absence of fraud* cuts off the wife's community interest. This may put an excessive reliance on corrective action based on fraud, but it is a perfectly rational principle of the community system as long as the husband continues as managing partner.[34]

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[33] The Texas legislature has attempted recently to settle the alleged uncertainty by amending the statutory definition of property. Tex. Sess. Laws 1957, c. 404. This amendment recites that an emergency was created "by the fact that the case of Warthan v. Haynes . . . casts some doubt on the status of life insurance as property." Accordingly, the definition of property in Article 23 of the 1925 Texas Revised Statute was amended to include "life insurance policies and the effects thereof." As to the effect of this amendment see Swift, House Bill 900 and Your Life Insurance Policy, 20 Tex. Bar. J. 691.

[34] This result may offend our sensibilities. Unquestionably, it is inconsistent with the concept of the community as an equal partnership. But it is not an aberration in the community property system attributable to failure of Texas courts to recognize insurance as property. It is a logical, though perhaps unnecessarily rigid extension of the orthodox basic principle that the husband is manager of the community and may expend it "ever so unwisely, may squander it in riotous living, or may give it away." There is a tighter rein on the husband in some community states.

If we may say so without being presumptuous, the solution is not to pass a law saying that insurance is property; of course it is property. There are a number of solutions. California attacks the problem broadly. Under Article 172 of the California Code, as interpreted in the courts, any gift of community property without the wife's written consent may be set aside as voidable. During the husband's lifetime the gift may be set aside completely; after the husband's death, insurance, for example, is voidable to the extent of one-half of the policy proceeds. New York Life Insurance Co. v. Bank of Italy, Cal. App. 1923, 214 Pac. 61. Narrowly, the legislature might declare that a gift from the husband to himself or to his estate is constructive fraud.

Summarizing, and readily admitting that our review of the Texas cases tends to oversimplify a complex subject, it seems to us that the following conclusions may be drawn. (1) Without using the terms, Texas courts do in fact recognize that insurance is property and in their holdings, if not their opinions, break down property in insurance between policy-rights and proceeds-rights. (2) Policy-rights in an insurance policy are property, a community asset, when the insurance is purchased with community funds. (3) The wife has a present, vested interest in this asset, as she has in all other community property. (4) This interest ceases, in the absence of fraud, when the policy matures and the bundle of policy rights is converted into insurance proceeds payable to a named third-party beneficiary, just as the wife's interest in any other community asset is cut off by transfer of the assets to a third person. (5) The transfer is from the community. Under *Blackmon* v. *Hansen*, only half of the proceeds fall in the husband's taxable estate. The other half is a taxable gift from the wife. (6) The Tax Court, therefore, is mistaken in attaching importance to the fact that "Marie did not have a community interest in the proceeds of the policy as against the named beneficiaries". That is the orthodox situation with respect

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Martin v. Moran almost said exactly this. Reimbursement of premiums to the community is a partial solution.

In Louisiana, as in Texas, a widow has no right to any part of insurance proceeds, if the policy is payable to a third person —even to her husband's illegitimate children or to his mistress. Sizeler v. Sizeler, La. S. Ct., 1930, 127 So. 388; Grayson v. Life Ins. Co. of Virginia, La. App., 1932, 144 So. 643. But under Article 2408 of the Civil Code (and perhaps regardless of this article) a husband cannot appropriate community property to his separate estate. Succession of Buddig, La. S. Ct., 1902, 32 So. 361; Succession of LeBlanc, La. S. Ct., 1917; Berry v. Franklin State Bank & Trust Co., La. S. Ct., 1937, 173 So. 126. Nabors, Insurance in Louisiana, 6 Tul. L. Rev. 515, 529 (1932).

to transfers in the absence of fraud and is not inconsistent with subjecting Marie's half to a gift tax.

B. Prior to the enactment of the Revenue Act of 1942, the federal courts generally recognized the tax implications of accepting insurance ~~as a community asset~~, whether the test of taxability was payment of premiums or possession of the incidents of ownership or both.[35] Some of the decisive cases were decided by this Court. This is of more than academic interest; in repealing the distasteful provisions of the Revenue Act of 1942 and enacting the Revenue Act of 1948 Congress revitalized the pre-1942 interpretations of community property law.

The first important federal tax case dealing with insurance purchased with community funds was *Newman* v. *Commissioner*, 5 Cir., 1935, 76 F. 2d 449, involving Louisiana law. The policy was revocably payable to the wife. This Court held that the proceeds were includible in full in the husband-insured's gross estate. The Court based its decision on the fact that the proceeds constituted a gift by the husband to the wife for which "the estate of neither is re-

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[35] In Hopkins v. Bacon, 1930, 282 U.S. 122, 51 S. Ct. 62, 75 L. Ed. 249, involving income taxes, the United States Supreme Court carefully reviewed the Texas cases on community property, including Martin v. Moran, Martin v. McAllister, and Rowlett v. Mitchell. The Supreme Court concluded that the wife's interest in community property in Texas is "properly characterized as a present vested interest", notwithstanding the husband's extensive powers of management and control. Husband and wife, therefore, are entitled to make separate income tax returns, each for one-half of the community income. A similar review and result were reached for Arizona in Goodell v. Koch, 1930, 282 U.S. 118, 51 S. Ct. 62, 75 L. Ed. 247; California in United States v. Malcolm, 1931, 282 U.S. 792, 51 S. Ct. 184, 75 L. Ed. 714; Louisiana in Bender v. Pfaff, 1930, 282 U.S. 127, 51 S. Ct. 64, 75 L. E. 252; and Washington in Poe v. Seaborn, 1930, 282 U.S. 101, 51 S. Ct. 58, 75 L. Ed. 239.

garded as having paid the premiums so as to be entitled to reimbursement". On the same type of policy and the same regulation, using the premium payment test, the United States Supreme Court reached the opposite result from the result reached in the *Newman* case. In *Lang* v. *Commissioner*, 1938, 304 U.S. 264, 58 S. Ct. 880, 82 L.Ed. 1331, the Supreme Court held that since community funds were used to pay the premiums, the wife contributing half, that the policies were "taken out" by the deceased husband-insured only to the extent of one-half of the proceeds. "In the absence of a clear declaration it cannot be assumed that Congress intended insurance bought and paid for with the funds of another than the insured and not payable to the latter's estate should be reckoned as a party of such estate for purpose of taxation." The Court held that the policies payable to the children should be accorded the same treatment as the policies payable to the wife.

DeLappe v. *Commissioner*, 5 Cir., 1940, 113 F. 2d 48, concerned a Louisiana insured husband who took out policies during the marriage naming irrevocably his wife, children, and others as beneficiaries. At this time, under Regulation 80, the incidents of ownership test and the premium payment tests were alternative tests of tax liability. Relying upon general principles of Louisiana law, this Court held that the proceeds of policies payable to a named beneficiary other than the estate of the deceased insured could be taxed in husband's estate only to the extent of one-half the proceeds. The Court specifically held that under community property principles, the wife owned one-half of the policies, since the insured husband paid premiums and exercised the incidents of ownership (including the power to change the beneficiary) as agent for the community, not as an individual owner. The *DeLappe* decision was followed in *Howard* v. *United States*, 5 Cir., 1942, 125 F. 2d 986.

The rationale of the *Lang, DeLappe,* and *Howard* cases is applicable to the existing tax situation as to estate and gift taxes. "The net result should be, it would appear, that incidents of ownership possessed by the husband such as the reserved power to change beneficiaries, under circumstances where the proceeds are payable to a named beneficiary, rather than the insured's estate, are incidents of ownership held as agent of the marital community. Thus, the proceeds should be includible to the extent of only one-half in the estate of the insured." Eichenbaum, Estate Taxation of Insurance Proceeds in Community Property States, 1952 Tulane Tax Institute, 251.

C. For a number of years pressure built up against community property states. Taxpayers in other states considered that they were discriminated against in tax treatment. Finally, in 1942 Congress adopted amendments to the estate and gift tax laws aimed directly at the community property states. These amendments taxed all community property to the first spouse to die, regardless of the surviving spouse's vested ownership of half of the property. The brief language of former section 811(g) of the Internal Revenue Code was replaced with an entirely new section 811(g)(4), the effect of which was to overrule by statute the *Lang, DeLappe,* and *Howard* cases. Under the 1942 law, the payment of premiums and the exercise of the incidents of ownership by the husband, was *not* as manager of the community but in his own behalf. This resulted in including all of the proceeds of insurance in the husband's estate.

The 1942 Act increased rather than diminished the agitation for equalization. It whetted the appetities of the common-law states for income tax equalization. It produced hardships and dissatisfaction among taxpayers in com-

munity property states.[36] After long negotiations between representatives of the taxpayers in the two groups of states, and representatives of the Treasury and of Congress, with all ultimately in agreement, Congress repealed the unfortunate amendments in the 1942 act and adopted the equalization bill as part of the Revenue Act of 1948.[37] This law makes comprehensive changes in income, gift, and estate tax laws designed to equalize all these taxes between taxpayers in common law states and taxpayers in community states. The 1948 Act recognizes the realities of spousal ownership in a community property system. Equalization in income taxes is achieved by allowing the joint return. Equalization in estate and gift taxes is achieved for noncommunity property by the marital deduction and split gift provisions.[38] In the case of life insurance, the repeal of Section 811(g)(4) was intended to make applicable "the rules of Section 811(g) which would be applicable had paragraph (4) never been contained in Section 811(g).

The effect of repeal of the 1942 Act is to bring a return to the rule of the *Lang*, *DeLappe*, and *Howard* cases: incidents of ownership possessed by the husband, such as the power to change beneficiaries, are held as agent of the

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[36] The community property states made a concerted but unsuccessful frontal attack on the constitutionality of the amendments. Weiner v. Fernandez, 1945, La., 326 U.S. 340, 66 S. Ct. 178, 90 L. Ed. 116. See Jackson, The Weiner case, 18 Tul. L. Rev. 525 (1944).

[37] Revenue Act of 1948, Sections 301, 302, 303, 351, 361, 363, amending Int. Rev. Code of 1939, Sections 12, 23(aa), 51(b), 811(d), (Sec. 811(c)(2) repealed), 812, 813 and 936(b). For a statement of the reaction to the 1948 Act of an informed attorney with a common-law point of view, see Surrey, Federal Taxation of the Family—the Revenue Act of 1948, 61 Harv. L. Rev. 1097 (1948).

[38] Int. Rev. Code of 1939, Sec. 812(e) as amended, Int. Rev. Code of 1954, Sec. 2056; Int. Rev. Code of 1939, Sections 1000, 1004 as amended, Int. Rev. Code of 1954, Sections 2513, 2523.

community; the proceeds, therefore, are includible to the extent of only one-half in the estate of the insured; the other half would be taxable as a gift by the wife, if the proceeds are payable to a third person. In order to conform the Treasury Regulations with the equalization measures, the Commissioner issued Treasury Decisions 5698 and 5699, 1949-1, 181, 226, the Cum. Bull. 181, 266 amending the gift and estate tax regulations. Treasury Decision 5698, issued May 13, 1949 added to the gift tax regulations, Section 86.2(a), the following subsection:

> "(9) Where property held by a husband and wife as community property is used to purchase insurance upon the husband's life and a third person is revocably designated as beneficiary and under the State law the husband's death is considered to make absolute the transfer by the wife, there is a gift by the wife at the time of such death of one-half the amount of the proceeds of such insurance."

After some uncertainty, the Internal Revenue Bureau has clarified its position by several rulings. Rev. Rul. 48, 1953-1 Cum. Bull. 392;[39] Rev. Rul. 232, 1953-22 Cum. Bull. 21 These rulings recognize that the policy-rights in insurance payable revocably to a third person beneficiary inure to the benefit

[39] "It is the position of the Bureau that, under the laws of Louisiana and Texas, a gift by the wife of one-half of the policy proceeds becomes absolute, for Federal gift tax purposes, upon the death of the husband, unless he purchased the policy with intent to defraud the wife, since at that time the community is dissolved, the authority of the husband as statutory manager of the community is ended, the policy matures, and the wife's interest therein is terminated; whereas, during the existence of the marital community any revocable transfer of rights is necessarily incomplete since the husband, acting for himself and as agent of his wife, may change the beneficiary, surrender the policy for cash, or exercise other legal incidents of ownership in accordance with the terms of the policy or the laws of the State." Rev. Rul. 48, 1953-1 Cum. Bull. 392.

of the community; therefore, under Treasury Regulations 105, Section 81.27 the proceeds are includible in the insured's gross estate to the extent of one-half under the incidents of ownership tests; and, under Treasury Regulation 108, Section 86.2(a)(9), the wife makes a gift of the other half upon the death of the insured husband.

Cutting through all of this review of cases and statutes and regulations is the sharp knife of the intendment of Congress in imposing gift and estate taxes generally, and as set forth in the 1948 Act. Failure to give effect to the regulations will defeat the national policy of tax equalization.

Judges and lawyers hypnotize themselves with words. In Texas the words were: "insurance is not property." The Tax Court here could not escape the phrase "the wife has no interest in *proceeds*." But gift and estate taxation of insurance is not based on receipt of proceeds. It is based on the *transfer* of property rights.[40] All gifts and estate taxes are based on the transfer of effective control over property rights, not the donee's or heir's receipt of property. Insurance proceeds are a measure of the value of the transfer. "The question propounded by the Court of Claims in form suggest that the tax is one imposed by the statute upon the policies. This we have shown is not the case. It is the transfer that is the subject of the tax. The tax is not on the

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[40] In Blackmon v. Hansen, 1943, 140 Tex. 536, 169 S.W. 2d 392 the Texas Supreme Court pointed out that the federal estate tax is measured by the right to transfer and the state tax inheritance tax the right to receive. But, said the Court, "after all, the two laws are similar, in that the *transfer taxed is of the same thing*, the receipt whereof is taxed." The Blackmon case held that where insurance is payable to the husband's estate, one half of the proceeds only is included in the husband's estate. Calvert v. Thompson, Tex. Civ. App., 1957, 301 S.W. 2d 496 held that where the insured husband survived the wife, one half of the cash surrender value of the insurance is included in the estate of the deceased wife.

policies." *Chase National Bank* v. *United States*, 278 U.S. 327, 49 S. Ct. 126, 73 L. Ed. 405 (1939). The *Newman* case was overruled, but what this Court said then as to the incidence of gift taxes, we say again now, with a slight change, italicized: "We think it plain that the statute in question imposes a death tax, not upon the proceeds of insurance policies, the property of the estate, nor upon the proceeds of insurance policies which but for the gift of the beneficiary would be owned by decedent, *but upon the cessation of* the control he had over the policies, [*as agent of the community*] so that his death vested in the beneficiary a settled right which she did not have before." *Newman* v. *Commissioner*, 5 Cir., 1935, 76 F. 2d 450. See also *Commissioner* v. *Wemyss*, 1945, 342 U.S. 303, 65 S. Ct. 652, 89 L. Ed. 958; *Commissioner* v. *Berger*, 2 Cir., 1952, 201 F. 2d 171; *Hooker* v. *Commissioner*, 5 Cir., 1949, 174 F. 2d 863.

In a community property state where insurance on the husband's life is purchased with community funds, payable revocably to a third person beneficiary, the husband's right to change the beneficiary and all other control over the property are held as agent of the community. The bundle of rights in the policy are owned by the community. Something happens to this bundle when the insured dies thereby terminating his control over the property and bringing the community to an end. What happens is, that the community's property interests in the policy-rights are transformed into the beneficiary's right to the proceeds. This is not a mystical transfiguration. It is a shift in control and a shift of beneficial interest. This is the transfer that is taxed.

Up to the time of his death, Daniel, as managing agent of the community, had the right to change beneficiaries. When he died without exercising this right, the transfer to the trustee was a completed gift from the community: one-

half therefore should have fallen in the taxable estate of the deceased husband. The other half is a taxable gift from the surviving spouse.

Under the terms of the trust agreement Marie was the income beneficiary for life. Accordingly, the measure of her gift was half the amount of the proceeds less a life estate in that half.

VII. Transferee Liability.

On appeal counsel for the taxpayer argue that even if Marie made a gift at the time of Daniel's death, the value of such gift could not exceed the value of her half of the cash surrender value of the policies less the value of her retained life interest.

Counsel cite *Womack* v. *Womack* and *Warthan* v. *Haynes*. The *Womack* case was a divorce suit. Both spouses were still alive. The only property that could be divided was the cash surrender value. In the *Warthan* case, although the wife died first, cash surrender values were not at issue; the Court awarded the proceeds to the named beneficiary (the husband's separate estate). More in point is *Blackmon* v. *Hansen* holding that where insurance is paid for with community funds, one-half of the proceeds should be included in the husband's estate for state inheritance tax purposes; one-half [is] the property of the wife and that part is no part of the estate of the husband."

Counsel for the taxpayer relies on a line of cases involving transferee liability for income taxes, citing especially two recent Supreme Court decisions: *Commissioner* v. *Stern*, 1958, ... U.S. ....., 78 S.Ct. 12, 2 L.ed. 2d 1126 and *United States* v. *Bess*, 1958, ...; U.S. ....., 78 S.Ct. 2 L.ed. 2d 1135. These cases and similar cases involving transferee liability for income taxes are inapplicable. The Supreme Court considered that transferee liability depend-

ed on whether or not a federal lien attached while the insured, the tax debtor, was still alive. If so, the commissioner could collect up to the cash surrender value only.[41] In cases involving income taxes, the liability necessarily attaches during the life of the insured, when the only property that the debtor has in insurance (disregarding replacement value or reserve value) is the cash surrender value. That is all he could transfer and all that could be subject to the government's lien. It is quite different from transferee liability for estate or gift taxes. Here, liability cannot attach until the transfer; and the transfer itself is the subject of the tax liability. Cash surrender has no significance in this case; the transfer is of proceeds.

As the court pointed out expressly in *Rowen* v. *Commissioner*, 2 Cir., 1954, 215 F. 2d 641, 646, the "cash surrender value were assets of the decedent's in his lifetime"; the proceeds of insurance policies were subject to transferee liability in the hands of the beneficiaries for estate tax purposes. The result would be the same as to the gift tax. The two taxes are in *pari materia* and must be construed together. *Merrill* v. *Fahs*, 1945, 324 U.S. 308, 311, 65 S.Ct. 655, 89 L.ed. 963. The gift tax transferee provisions (Section 1025 of the 1939 Code) like the estate tax provisions (Sections 827 and 900 of the 1939 Code) plainly extend to all transferred property including the proceeds of life insurance.

VIII. The Living Trust.

The Tax Court held that the living trust was "clearly testamentary". The principal, therefore, remained community property, and Daniel had no power to deprive Marie

[41] It has been argued that the beneficiary should be liable for the full proceeds transferred. Grayck, Transferee Liability of Insurance Beneficiary, 13 Tax Law Rev. 313 (1958).

of her share of the community. When, however, Marie "chose to abide by the terms of the trust in accepting payments of income, she elected to waive and surrender her property interest in the principal thereof and made a taxable gift".

This reasoning disregards the fact that if the trust were testamentary, it would be invalid because of the Statute of Wills, and Daniel's half would fall into his residuary estate. Marie could not cure the invalidity by surrendering her half of the community. There would be no valid trust to which she could surrender her property.

A. Scott,[42] Bogert,[43] and The Restatement[44] do not

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[42] See 1 Scott on Trusts, Section 57, p. 442 et seq.

[43] "A trust is not made testamentary by the coupling together of a life interest in the settlor and a power in him to revoke, or the joinder of these two factors." 1 Bogert, Section 103, p. 483. The most recent ALR annotation in this subject summarizes the law: "The later cases agree that the two elements, reservation of a life interest and a power to revoke, do not invalidate a deed of trust or render it to any extent inoperative for want of execution as a will. This holds true notwithstanding the reservations of all the income . . . for the settlor's life." 32 ALR 2d 1270, 1272 (1953).

[44] Scott, Reporter for the Restatement of Trusts, makes the point that the nature of the trust instrument is important. "If the creation of a trust is evidenced by a formal trust instrument, it would seem that the danger of fraud is not increased by the fact that the settlor may have reserved extensive powers." A revision of the Restatement of Trusts, Section 57, adopted in 1947 reads "Where by the terms of the trust an interest passes to the beneficiary during the life of the settlor, the trust is not testamentary merely because the settlor reserves a beneficial life estate or because he reserves in addition a power to revoke the trust in whole or in part and a power to modify the trust, *and a power to control the trustee as to the Administration of the trust, and the disposition will not be invalid for failure to comply with the requirements of the Statute of Wills unless the terms are so informally stated and the power of control reserved is so great that it would violate the policy of the Statute of Wills to enforce it.*" The italicized language was added in the 1947 revision of the section originally adopted in 1935. The Moran trust agreement is a typical, formal trust instrument of the type used by New York banks.

share the Tax Court view that such a trust is "clearly testamentary". On the contrary, "It has been universally held that the creation of a trust inter vivos is not a testamentary disposition merely because the settlor reserves a power to revoke the trust or to modify it, even though in addition he reserves a beneficial life interest in the trust property." Scott, The Effects of a Power to Revoke a Trust, 57 Harv. L. Rev. 362, 368 (1944). Virtually no cases can be found holding a contrary view. The trust comes into being at the time when the settlor delivers the property to the trustee, and all the beneficiaries acquire interests in the trust at that time, even though there is a condition subsequent allowing the settlor to deprive the beneficiaries of their interests. Unlike a will, "the death of the settlor is not a condition precedent to the vesting of the interest in the beneficiary. The distinction between a disposition to take effect only on the death of the donor and one to take effect immediately but subject to be revoked may seem to be formal rather than substantial, but it is an important one, and one which has a determinative effect on other problems [the reach of creditors, for example]." 1 Scott, Section 57.1 p. 445. Here, Marie acquired an interest when the trust was created, a future interest but an interest. It was subject to divestment, but once acquired, it might never be divested. In fact, it was not divested.

Add the power to modify and revoke the trust, and the law is still clear that the trust is on the right side of the line. Add the element of control over the trustee's administration and the trust may cross the line or come so close to the line that courts will divide as to whether a trust is not a trust but a will, depending on the degree of control reserved. Where, however, in an "illusory" trust the settlor "reserves such power to control the trustee in the administration of the trust that in effect the trustee is merely his

agent acting under his direction, the disposition is testamentary". Scott, the Effects of a Power to Revoke a Trust, 57 Harv. L. Rev. 362, 371 (1944).

Here, a close examination of the Moran living trust agreement shows not a word or clause to indicate any intention by the settlor to control the trustee. Further, the trustee is given broad powers of administration, including the right to retain or purchase non-legals and "in its discretion" to make any investments "it may choose".

B. In concluding that the trust was testamentary, the Tax Court relies on a line of New York cases holding certain trusts "illusory", citing *Newman* v. *Dore*, 1937, 275 N.Y. 371, 9 N.E. 2d 966, the leading case, *Hirschfield* v. *Ralson*, 1926, 66 N.Y.S. 2d 59, and In Re *Sanchez' Estate*, 1945, 58 N.Y.S. 2d 230. With due deference, it seems to us that these cases are inapplicable.

In *Newman* v. *Dore* a married man transferred *all* of his property in trust reserving a life estate and the power of revocation. The trust agreement stated that trustee's powers were "subject to the settlor's control during his life" and could be exercised "in such manner only as the settlor shall from time to time direct in writing". As the Court said, "the settlor reserved substantially the same rights to enjoy and control the disposition of the property he previously had possessed". In Re *Sanchez' Estate* concerned a transfer of a stock certificate by a husband with intent to defraud his creditors, among them his wife from whom he was separated. Sanchez retained possession and control of the certificate. The Court found that the transfer was fraudulent and illusory. In *Hirschfield* v. *Ralston*, the complaint alleged that a husband conveyed his business to a third person through transfer of stock, to defraud his wife of her distributive share of his estate and to disinherit his

daughter. The Court held that the complaint failed to state a cause of action, because there was no allegation that the husband owned and controlled the business and the stock at the time of his death.

These cases are typical of illusory trusts. There is seldom an express trust by agreement, as in the Moran trust, or, if there is, the settlor in terms reserves virtually complete control over the trustee's administration of the trust. In either instance, the transferor reserves such a degree of control over the property that the Court is driven to the conclusion there is no real intent to transfer and that the whole transaction is a sham.[45]

In addition, in the illusory trust cases there is an intent to deprive the wife of her expectant interest, her distributive share, and in most of the cases there is an intent to defraud the wife by transferring property to a third person. In none of the cases does the husband give his wife any beneficial interest in the so-called trust. None of these circumstances are shown to exist here. Newman died three days after he executed his trust. Had the Newman trust been upheld, his wife would have received nothing. Had Daniel died three days after November 28, 1948, the value of Marie's life interest in the whole of the trust estate would have exceeded the value of her half interest in the community. There is nothing in the record to show that Daniel influenced the trustee in any way in its administration of the trust. There is no showing that the income from the Moran living trust was handled any differently from Dan-

[45] In the illusory trust cases, "the settlor's control over property during his lifetime is so complete that to hold that it should not be included in the determination of the widow's distributive share would be clearly a violation of the statute which is to give the widow a share of all the property owned by him on his death." Scott, The Effects of a Power to Revoke a Trust, 57 Harv. L. Rev. 362, 371 (1944).

iel's earnings and other income; even revenue from a husband's separate property is community, under the law of Texas.

It must be borne in mind that *Daniel did not create the trust. The community created it.* Any rights that were reserved in the settlor were rights held by the community. Newman exercised control over his trust property for himself; Daniel's control (in his case restricted to the right of revocation and modification) could be exercised only *as agent for the community.*

Much closer in point is *Marine Midland Trust Co.* v. *Stanford*, 256 App. Div. 26, 9 N.Y.S. 2d 648, 1939, aff'd mem. 281 N.Y. 760, 24 N.E. 2d 20, 1939. There the Court upheld a transfer in trust where a husband retained the life estate, right of revocation and modification, and also the right to withdraw the principal not to exceed $2,000 in any year. The husband had previously turned over a little better than half of his estate to his wife from whom he was separated. The Court distinguished *Newman* v. *Dore* on the grounds that a trust is not illusory, if made with intent to transfer actual title. In arriving at the intent the Court emphasized that equities between the spouses may be considered.[46]

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[46] Dunnett v. Shields, 1924, 97 Vt. 419, 123 Atl. 626, is not a New York case, but in applying the illusory trust doctrine New York Courts have of course relied, in part, on decisions of other states. In that case a widow brought suit to set aside a trust created by her husband during his lifetime. The widow claimed that the trust was invalid because it was a fraud upon her rights to her elective share. The trust reserved the right of revocation to the husband-settlor and also gave the husband a life estate in the trust income. At his death the wife was to have a life estate in the income, and at her death the trust provided for the ultimate distribution of the principal to others. The court expressly found that the trust was made for the purpose of providing income to the wife after the husband's death, and that the trust was set up so that the property would not become a part of the husband's estate and as such subject to the exercise of the widow's statutory

In the "illusory" trust cases the wife receives nothing. In each case the transfer is a sham devised by the husband to deprive the wife of her distributive share by making a purported gift to another while still retaining control. Here there is no pretense of any fraud. There is no showing that Daniel intended to deprive Marie of any rights or that the trust had that effect. On the contrary, Daniel wanted his wife to have her share and his too, but free of the burden of capital management. The income he received was community income.

C. There are no illusory trust cases in Texas. The fact situation in such cases would be subject to the principle that, in the absence of fraud, a husband may transfer community property by gift or sale although the effect may be to divest the wife of her one-half interest in the property. To set aside a transfer as fraudulent, there would have to be an action by the wife or her heirs.

The Tax Court states, however, that under the law of

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rights. The issue as stated by the court was whether when no express intent to defraud is found in fact, such a conveyance as was made in the instant case can be said to be fraudulent in law. The court held no. Actual fraud in fact must be proved, and the mere fact that the settlor knew the effect of the conveyance was to deprive the wife of her elective share and give her a life estate in the same property does not give rise to a legal presumption of fraud. The Court stated: " . . . can it be said that where provision is made 'primarily for the benefit of the widow, who has the right thereunder, if necessary, to have the entire estate used for her support,' . . . that the trust falls in the eyes of the law? We do not think so." See also Shawmut Bank v. Cumming, 1950, 325 Mass. 457, 91 N.E. 2d 337; Kerwin v. Donaghy, 1945, 317 Mass. 559, 59 N.E. 2d 299; Boyle v. John M. Smyth Co., 1928, 248 Ill. App. 57. In Beirne v. Continental Equitable Title and Trust Co., 1932, 307 Pa. 570, 161 A. 721 the Court upheld a trust where the husband had the right to revoke and reserved the life estate but had no control over the trustee—although the declared purpose of the trust was to defeat the wife's rights in any assets.

Texas the living trust was not sufficient to pass a present interest, citing *Armington* v. *Gilcrease Oil Co.*, 190 S.W. 2d 587, 595 (Tex. Civ. App.); *Fleck* v. *Baldwin*, 141 Tex. 340, 345, 172 S.W. 2d 975, 978; *Bridewell* v. *Clay*, 185 S.W. 2d 170, 172 (Tex. Civ. App.) and *Postal Mutual Indemnity Co.* v. *Penn*, 165 S.W. 2d 495, 499 (Tex. Civ. App.).

This statement is not in accord with our understanding of the law of Texas. *Bridewell* v. *Clay* and *Postal Mutual Indemnity Co.* v. *Penn* did not involve trusts. *Bridewell* v. *Clay* simply held that a gift of a check is revocable until presented for payment. In *Postal Mutual Indemnity Co.* v. *Penn*, a workmen's compensation case concerning proof of dependency, the question was whether the dependent wife had received certain rent as a gift. In *Armington* v. *Gilcrease* the Armingtons purchased mineral leases but directed the seller to delay execution of the assignments until they decided to whom they wanted to make the assignments, reserving the revenue for themselves in the meantime. They had complete control and the gifts were never completed. *Fleck* v. *Baldwin* involved so-called "tentative trusts", bank savings accounts and certificates for stock in building and loan companies, placed in the name of "Mrs. J. C. Baldwin, in trust for Mrs. Fleck". Mrs. Baldwin retained possession of the passbooks and certificates and, as the Court said, "she still regarded them as her own . . . and never intentionally parted with her right to exercise dominion and control over any part of her estate but constantly retained and exercised authority to use and dispose of it as she willed".

We have not found any Texas case that passed directly on the facts as presented by the Moran trust agreement. We believe that Texas courts would uphold the trust. *Schmidt* v. *Schmidt*, Civ. App. Tex., 1953, 261 S.W. 2d 892 distinguished *Fleck* v. *Baldwin* and similar cases: "Each of the

cited cases involved the question whether or not certain acts by a principal constituted a "gift inter vivos or simply an 'agency' . . . None of these cases is authority for the proposition that the owner of land may not convey the legal title thereto to another person and retain in himself the equitable or beneficial title", citing the Restatement, 1 Trusts, Sec. 114, and the Texas Trust Act, Art. 7425b-7 of the Revised Civil Statutes of Texas, Vernon's Ann. Civ. St. This article permits a settlor to be a beneficiary. Article 7425b-41 provides that "every trust shall be revocable by the trustor during his lifetime, unless expressly made irrevocable." Together, the two articles seem to say that there is no logical impediment in Texas trust concepts to a trust such as the Moran living trust.

We hold that the Moran living trust was not ambulatory; it was a present, valid trust created in 1928. Marie is the income beneficiary under the express terms of that trust and not because she receives the income in exchange for relinquishing her half of the community as part of an assumed election to accept the benefits of the trust. We do not have before us, therefore, the question at issue in *Commissioner* v. *Siegel*, 9 Cir., 1958, 250 F. 2d 339, that is, whether the wife's election to take under the will should be considered as a gift by the wife or a purchase of an annuity supported by consideration.

D. Our holding does not mean that gift tax consequences attached at the time the trustee took title in 1928. In a transfer of property valid under state law, state law focuses on title. The federal gift and estate tax law focuses on transfer of the beneficial enjoyment of the property. One who creates a trust during his lifetime, even though he reserves a life estate, parts with legal title to the trustee and grants to the beneficiaries (including remainderman)

an immediate equitable title. Transfer of the possession and enjoyment of the property may be deferred until some future time. It is this very situation that causes the application of the gift and estate tax laws. Treasury Regulation 108, Section 86.3 provides therefore: "A gift [for tax purposes] is incomplete in every instance where a donor reserves the power to revest the beneficial title to the property in himself." The taxable incident is the shifting of the beneficial enjoyment in the trust property, no matter when title is vested. See *Brady* v. *Ham*, 1 Cir., 1930, 45 F. 2d 454.

Since Daniel retained the power of revocation (for the community), there was no taxable gift until the shift in beneficial enjoyment at his death. *Estate of Sanford* v. *Commissioner*, 1939, 308 U.S. 39, 60 S. Ct. 51, 84 L. Ed. 20; *Burnett* v. *Guggenheim*, 1933, 288 U.S. 280, 53 S. Ct. 369, 77 L. Ed. 748. When Daniel died the trust became irrevocable. His community one-half should have been included in his gross estate under Section 811(c) and 811(d) of the 1939 Code, and Marie made a taxable gift of the other half under Treasury Regulations, Section 86.2 and 86.3 less her retained life estate in such one-half.

Had Daniel been acting for himself instead of for the community, and had the right of revocation been retained by him individually the taxpayer would have been on stronger ground to urge that, as to Marie, the gift was complete in 1928. But it was as agent for the community, that Daniel held the right of revocation. For tax purposes the gift was incomplete until the right of revocation ceased on Daniel's death.

VIII.

Summarizing, we hold as follows:

1. As to the testamentary trust, we hold in favor of the taxpayer. The will of Daniel Moran did not put his wife

to an election, nor did she elect (assuming that the will put her to an election). There was, therefore, no taxable gift of Marie Moran's share of the community to the testamentary trust.

2. As to the insurance trust, we hold in favor of the Commissioner. On the death of the insured, for tax purposes half of the proceeds of the insurance belonged in Daniel Moran's gross estate and the other half was a taxable transfer from Mrs. Moran, less her retained life interest in that half.

3. As to the living trust, we hold partly in favor of the Commissioner and partly in favor of the taxpayer. We hold that on Daniel Moran's death the trust became irrevocable. His half of the community belonged in his gross estate and his wife's half was a taxable gift to the trust less her retained life interest in that half.

Accordingly, the judgment is REVERSED and the case REMANDED for any appropriate proceedings not inconsistent with this opinion.

Court of Appeals Judgment

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 16488

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

THE CHASE MANHATTAN BANK, Successor of The Chase National Bank of the City of New York, trustee and Alleged transferee of Marie Elizabeth Moran,
Respondent.

(and reverse title)

(August 19, 1958)

This cause came on to be heard on the petition of Commissioner of Internal Revenue and The Chase Manhattan Bank, Successor of the Chase National Bank of the City of New York, Trustee and Alleged Transferee of Marie Elizabeth Moran, for review of a decision of the Tax Court of the United States, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the judgment of the Tax Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby, remanded to the Tax Court for any appropriate proceedings not inconsistent with the opinion of this Court.

Court of Appeals Order Denying Rehearing

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 16488

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

THE CHASE MANHATTAN BANK, Successor of The Chase National Bank of the City of New York, trustee and Alleged transferee of Marie Elizabeth Moran,

Respondent.

(and reverse title)

(October 23, 1958)

It is ordered by the Court that the petition for rehearing filed in this cause be, and the same is hereby, denied.

APPENDIX C
Conflicting Ninth Circuit Opinion

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 15432

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

MILDRED IRENE SIEGEL,
Respondent.

Petition for Review of Decision of the Tax Court of the United States

(November 6, 1957)
(250 F. 2d 339)

Before FEE and BARNES, Circuit Judges, and YANKWICH, District Judge.

YANKWICH, District Judge.

The question involved in this petition by the Commissioner of Internal Revenue to review[1] a decision of the Tax Court rendered October 3, 1956, turns on the correctness of the determination by the Tax Court of a deficiency, arising under the federal gift tax law for the taxable year 1950, of the respondent Mildred Irene Siegel, to be referred to hereinafter as the taxpayer.[2]

[1] 26 U.S.C, 1952 Ed. §1141(a) and (c) (1); I.R.C. 1954, §7482(a) and (c) (1), 26 U.S.C. §7482(a), (c) (1); Rule 52(a), Federal Rules of Civil Procedure, 28 U.S.C.

[2] 26 T.C., Prentice-Hall Ed., 743.

On February 8, 1954, the Commissioner of Internal Revenue mailed to the taxpayer a notice of a deficiency in the total amount of $51,144.24. The assessment was based on a determination which read in part:

> "The transfer by the above-named donor to her son of a remainder interest in her one-half interest in community property which she transferred to a testamentary trust established under the last will and testament of Irving Siegel, Deceased, is determined to constitute a transfer by said donor without consideration in money or money's worth, and a gift within the meaning of Section 1000 of the Internal Revenue Code."

On April 29, 1954, the taxpayer filed a petition with the Tax Court for a redetermination of the deficiency.[3] The Tax Court entered its decision on October 3, 1956, determining, in effect, that the taxpayer's transfer having been made in consideration of her waiver of her community rights and her acceptance of the benefits under the will, only the excess of the value of her transfer over what she received was a taxable gift. The Tax Court determined the amount to be $4,314.87, which has been paid.

I.

Facts Admitted or Uncontroverted.

1. In the main, the facts are not in dispute, either because they were stipulated or found by the Court on evidence which stands uncontradicted. So, unless the facts warrant different legal conclusions, the decision of the Tax Court must stand.[4]

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[3] I.R.C., 1954, §6213, 26 U.S.C. §6213.

[4] Gillette's Estate v. Commissioner, 9 Cir. 1950, 182 F. 2d 1010, 1013-1015; Gensinger v. Commissioner, 9 Cir., 1953, 208 F. 2d 576, 583; McGah v. Commissioner, 9 Cir., 1954, 210 F. 2d 769, 771; Wener v. Commissioner, 9 Cir., 1957, 242, F. 2d 938, 944-945.

In outline, the facts are:

The taxpayer and Irving Siegel, to be referred to as Siegel, were husband and wife and residents of the State of California. Sigel died in California on January 4, 1949. The Siegels had an adopted son, Richard Bruce Siegel, who was born on May 14, 1943, and who resides with the taxpayer. Siegel left an estate consisting entirely of community property acquired by him, as the Tax Court found, and his wife since 1927.[5] The Tax Court also found that on the date of Siegel's death, the gross value of the community property was $1,422,897.14, and the gross value of the taxpayer's half share in it was $711,448.57. At the time of the hearing, the Tax Court determined that on January 5, 1950, the date of the taxpayer's election to take under the Will, to be referred to later on, the net value of Siegel's share to be $295,076.54 and that of the taxpayer's $584,035.44. The computation was arrived at in this manner:

	Siegel's Share	Taxpayer's Share
Gross value at Irving's death	$711,448.57	$711,448.57
Less:		
Debts and administration expenses	114,886.25	114,886.25
Federal estate tax	201,840.48	
Inheritance taxes on bequests other than to petitioner	26,145.30	
Inheritance tax on bequests to petitioner		9,026.88
Legacies other than to petitioner	35,000.00	
Legacy to petitioner	35,000.00	
Automobiles bequeathed to petitioner	3,500.00	3,500.00
Total deductions	$416,372.03	$127,413.13
Net value	$295,076.54	$584,035.44

[5] California Civil Code, §§164, 687.

Siegel left a Will, dated March 28, 1948, which was admitted to probate in the Superior Court of Los Angeles County, California, on February 3, 1949. The will contained a provision bequeathing to the taxpayer, in addition to some minor gifts, the sum of $35,000 ("to offset", as the will stated, a like sum bequeathed to his "sisters and nephew") and created a trust to pay to her during her lifetime, and to the son, thereafter, the income of the estate. The instrument provided that the payments shall be such as the trustees

> "deem proper to maintain at least the same standard of living to which she has been accustomed in recent years, but in no event less than the sum of $1000.00 per month."

The taxpayer was named one of three trustees and the will specifically provided that should she determine to take her community property share, "she should take nothing as a beneficiary under the trust". The three clauses relating to these matters are set forth in the margin.[6] The reference

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[6] "Three: I give, devise and bequeath to my beloved wife, Mildred Irene Siegel, the property which I may be occupying at the time of my death as my home, together with the furniture, furnishings and equipment located therein, all my personal effects as well as any automobiles which I may own at the time of my death, and in addition thereto I give, devise and bequeath to my said wife, the sum of Thirty-Five Thousand ($35,000.00) Dollars, which bequest is made primarily to offset the thirty-five thousand dollars which I am hereinafter bequeathing to my sisters and nephew, to the end that she may either retain this sum for her own use and benefit or divide it among her relatives in such manner as she may see fit.

* * * *

"Seven: All the rest, residue and remainder of my estate I give, devise and bequeath to my wife, Mildred Irene Siegel, Ben Weingart and N. B. Alison, or the survivor of them In Trust, however, for the uses and purposes hereinafter specified and not otherwise:

to the standard of living in the will is important in view of the fact that the Tax Court found that in 1948, the year preceding his death, the living expenses of the taxpayer and her husband before income taxes were $46,500.

On January 5, 1950, the taxpayer executed and filed with the Superior Court an instrument electing to take under Siegel's last will and testament in lieu of all community property rights which she had in the estate. The Tax Court

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"(a) To pay to my beloved wife, Mildred Irene Siegel, for the support, maintenance and care of herself and our beloved son, Richard Bruce Siegel, such sum as in the sole discretion of the majority of said trustees they deem proper to maintain at least the same standard of living to which she has been accustomed in recent years, but in no event less than the sum of One Thousand ($1,000.00) Dollars per month;

* * * * *

"(c) In the event the net income from my trust estate is not sufficient to make the payments above provided, then and in that event I specifically authorize my Trustees to make payments from the corpus of said trust estate to the extent necessary to provide for the payments as above set forth;

* * * *

"(j) I specifically direct that during the life of the three trustees herein named, a majority thereof shall be authorized to act for and on behalf of said trustees, which if two living it shall require their unanimous approval, and if they are not able to agree, then either may petition the Court having jurisdiction of the probate of my estate for instructions;

* * * *

"Eight: The provisions made in this my Last Will and Testament for my beloved wife, Mildred Irene Siegel, are in lieu of her community rights and interests, and if she elects to take her community interest, in lieu of taking under this my Last Will and Testament, then the bequests made to her in Paragraph Three hereof shall be of no force and effect and the real and personal property so bequeathed shall become a part of the rest, residue and remainder of my said estate to be distributed to my said trustees, and likewise subdivision (a) of paragraph Seven shall be of no force and effect and she shall take nothing as a beneficiary under said trust."

found that since that time, she received and expended from the trust the following amounts:

	Received from the trust	Total expenditures	Federal and State income taxes included in total expenditures
1950	[1]$24,000	$31,720.32	$ 4,500.00
1951	54,000	50,462.11	18,524.23
1952	54,000	43,313.60	20,296.83
1953	52,000	46,656.79	18,413.06
1954	48,000	47,267.98	22,329.39

([1]Taxpayer also received an $18,000 allowance from Siegel's estate in 1950.)

In setting up these tables, the Tax Court made the following additional findings:

> "Included in the above total expenditures were sums expended by petitioner for the support of her and Irving's son which averaged well under $3,000 per year.
>
> "Under the economic conditions existing during the years subsequent to decedent's death and prior to this hearing it would cost petitioner $45,000 per year, including income taxes to maintain the standard of living to which she was accustomed in recent years prior to decedent's death."

On the basis of these findings it concluded that the surrender by the taxpayer of her community property rights was a gift to the estate to the extent that the value of the interest thus surrendered exceeded the value of the interest she acquired under the terms of the will.

In determining the values the Tax Court ruled that the amount of the gift should be measured by the taxpayer's community interest reduced by the present value of her life interest in the entire community property and a specific bequest of $35,000 granted to her by the terms of the will.

In sum, the Tax Court treated the transfer as being one in which what the taxpayer surrendered *was the consideration* for what she received.

In this petition for review, the Commissioner contests this basic principle and the reasons upon which it is grounded.

II.

The Problem of Consideration.

It is the contention of the Commissioner that in this manner the Tax Court misapplied to the facts Section 1002 of the Revenue Code of 1939, which reads:

> "Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this chapter, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year."[7]

We are of the view that the Commissioner's contention that the transaction was donative and that, as his brief puts it, "the taxpayer received no consideration whatsoever, adequate or not, for making the election" is without merit. The issue must be determined in the light of the community property law of California and the law of wills.

The election made by the taxpayer reads:

> "Election of Widow to Take Under Will
>
> "I, the undersigned, Mildred I. Siegel, widow of Irving Siegel, deceased, do hereby elect to take under the Last Will and Testament of said deceased *in lieu of any and all community property rights which I have* in said estate." (Emphasis added.)
>
> "Dated this 5th day of January, 1950."

2. Elections to take under a will by one of the spouses instead of property that he or she may be entitled to under

[7] 26 U.S.C., 1952 Ed., §1002.

state law have long been recognized as transactions in which the property surrendered is considered the consideration for the offer made in the will and accepted at the time of the execution of the will in a contemporaneous instrument or thereafter. In all instances, the effect of the election is determined by the status of the property under the law of the state.[8]

"The gift by will in lieu of the other right is said to be equivalent to an offer, and to offer something to the devisee in return for his property or interest."[9]

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[8] 97 C.J.S. Wills §1287(d) (1) (2); Page on Wills, 3rd (Lifetime) Ed., 1941, Vol. 4, §1346, 1501, 1502, 1503. It is axiomatic that in applying federal revenue acts, the interests and rights to be taxed are determined by federal law, but "state law creates legal interests and rights". Morgan v. Commissioner, 1940, 309 U.S. 78, 80, 625, 626, 60 S. Ct. 424, 426, 84 L. Ed. 585, 1035. And see, Helvering v. Stuart, 1942, 317 U.S. 154, 162; Harris v. Commissioner, 1950, 340 U.S. 106, 71 S. Ct. 181, 95 L. Ed. 111; Nelson's Estate v. Commissioner, 1956, 5 Cir., 232 F. 2d 720, 724. This Court has held that for federal tax purposes, the nature of a transfer of a one-half interest in a California partnership from a father to a son, the income from which the son returned as community property, was to be determined by California law. The son paid for it by a promissory note in the sum of $100,000, payable without interest and out of the 25% of the son's share in the future earnings of the partnership. Some payments were made on the note. The transfer was evidenced by a bill of sale. The father and son treated the property *as a sale* and the son reported his income as *community property*. The Tax Court treated the transfer as a "gift". This Court reversed. It held that the transfer was a sale and that the son could

"forthwith convert the property, under California law, into community property by agreement between himself and his wife." Goold v. Commissioner, 9 Cir., 1950, 182 F. 2d 573, 575. And see, Blair v. Commissioner, 1937, 300 U.S. 5, 13, 57 S. Ct. 330, 81 L. Ed. 465; Goodwin's Estate v. Commissioner, 6. Cir., 1953, 201 F. 2d 576, 580-582. See, Comment, Joint Tenancy v. Community Property in California: Possible Effect Upon Federal Income Tax Basis, 3 U.C.L.A. Law Rev., 1956, pp. 636, 645-648.

[9] Page on Wills, supra, Note 8, §1346. Ragsdale v. Robinson, 1942, 219 Ind. 355, 38 N.E. 2d 570; Mead v. Phillips, 1943, 77 U.S. App. D.C. 365, 135 F. 2d 819, 824; Muse v. Muse, 1947, 186 Va. 914, 915, 45 S.E. 2d 158, 2 A.L.R. 2d 603.

3. Most writers on the law of contracts and Courts which have dealt with the matter are in accord that the property surrendered is a consideration for that which is accepted, and what may begin as a unilaterial offer turns into a binding contract upon such acceptance.[10]

In the present case, the Tax Court found that the property left by Siegel was community property acquired by Siegel and the taxpayer in California since 1927. *This date is of utmost importance.* For, since 1927, the interests of husband and wife in community property in California are declared to be "present, existing and equal interests".[11]

4. The California law of succession as to community property is stated in this manner:

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[10] Restatement on Contracts, §75(1) (c) (d), §90; Williston on Contracts, Revised Ed., 1936, §§13, 25, 101, 113; Corbin on Contracts, 1950, §194. And see cases sited in Note 9. The Court of Appeals for the District of Columbia, in interpreting Maryland law, has summed up the effect of election, even in dower states, in this manner:

"One cannot come to a market as a purchaser with a fair consideration, if, as was held in the Collins case, the husband has 'power by his will to bar, or extinguish the common law rights of his widow'. The concept of purchasing with a fair consideration assumes rights and powers in the widow which cannot be cut off, except by her own election, on a bargaining basis. If she is to be considered a purchaser with a fair consideration, there is implicit the idea of offer and acceptance — *that the husband's bequest is a valid offer which, to be binding, must be accepted by the widow.*" Mead v. Phillips, 1943, 77 U.S. App. D.C. 365, 135 F. 2d 819, 826. (Emphasis added.)

Writers have called the accepted distinction between bilateral and unilateral contracts artificial and false. See, Samuel J. Stoljar, The False Distinction Between Bilateral and Unilateral Contracts, 1955, 64 Yale Law Jr., 515, where reference is made to the extensive critical literature on the subject. But all agree that the acceptance of a one-sided offer, for a consideration, results in a binding contract. 17 C.J.S. Contracts §8; 12 Am. Jur., Contracts, §8; Restatement on Contracts, §§19(c), 76.

[11] California Civil Code, §161a.

> "§201. Succession. Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse, subject to the provisions of sections 202 and 203 of this code."[12]

The husband and wife may alter their legal relations as to property[13] and only one-half of the community property is subject to the testamentary disposition of the decedent.[14] When the husband makes a testamentary disposition of more than half of the community property and the wife chooses to take under the will, the half interest in the estate which she surrenders is a contract supported by adequate consideration. As stated by the Supreme Court of California in a noted case:

> "The 'waiver' was in fact a contract, by the terms of which plaintiff accepted certain devises and bequests under the will in lieu of any right she might have in any community property. Such an agreement is clearly supported by consideration and is binding upon the plaintiff, irrespective of any element of estoppel arising from the testator's change of position in reliance upon the representation contained in the instrument."[15]

And the rule is the same whether the waiver be attached to the will or is contained in a separate instrument.[16] The

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[12] California Probate Code, §201.

[13] California Civil Code, §159.

[14] California Probate Code, §201.

[15] Flanagan v. Capital National Bank of Sacramento, 1931, 213 Cal. 664, 666, 3 P. 2d 307, 308.

[16] In re Estate of Chapin, 1941, 47 Cal. App. 2d 605, 610, 118 P. 2d 499; Opp v. Frye, 1945, 70 Cal. App. 2d 478, 490-491, 161 P. 2d 235.

wife is not put upon her election until the estate is ready for distribution.[17]

In view of the vested character of the interest of the wife in community property under California law even before death, if the property was *as was the case here*, acquired since July 29, 1927,[18] decisions arising in states in which the wife has a mere dower right are not controlling. Indeed the decision of the Court of Appeals for the Second Circuit, made under New York state law on which the Commissioner relies represents a minority view.[19] A majority of the cases hold that although the widow's dower right is inchoate[20] upon the death of the husband she acquires a vested interest[21] and becomes "a purchaser for value."[22]

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[17] In re Estate of McCarthy, 1932, 127 Cal. App. 80, 85-86, 15 P. 2d 223; In re Estate of Roberts, 1945, 27 Cal. 2d 70, 75, 162 P. 2d 461; In re Estate of Kelley 1953, 122 Cal. App. 2d 42, 43-44, 264 P. 2d 210.

[18] California Civil Code, §161a; California Probate Code, §201.

[19] Such as, e. g., Warner v. C.I.R., 2 Cir., 1933, 66 F. 2d 403.

[20] 28 C.J.S. Dower §42; 17-A Am. Jur., Dower, §77. In an old case the Supreme Court stated that

"During the life of the husband the right is a mere expectancy or possibility." Randall v. Kreiger, 1874, 23 Wall. 137, 148, 90 U.S. 137, 23 L. Ed. 124.

[21] This Court, in interpreting the law of dower of Montana, has said:

"Under Montana law the dower interest of a wife is *merely an inchoate right — whether treated as a bare expectancy or as a contingent interest — which does not become consummate until the husband's death.*" Bateman v. Donovan, 9 Cir., 1943, 131 F. 2d 759, 763. (Emphasis added.)

[22] The general rule is epitomized in an annotation to Muse v. Muse, supra, Note 9, entitled "Priority of surviving spouse who accepts provision of Will in lieu of dower or other marital rights over other legatees and devisees and creditors." (2 A.L.R. 2d 607), in this manner:

"• • • the weight of authority is that since *it is in consideration of an existing legal right, it constitutes the widow a purchaser for value* and for that reason is entitled to priority over other general legacies or devises to volunteers of the testator's bounty, which must abate in the widow's favor." (Ibid., at page 610) (Emphasis added.)

A leading Massachusetts case has summed up the principle in this manner:

> "The widow is a purchaser for value, in accepting the provisions of the will, and is not treated as a gratuitous object of the testator's bounty. By a relinquishment of her dower, the estate acquires a valuable right of property."[23]

There is general accord on the subject.[24]

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[23] Borden v. Jenks, 1886, 140 Mass. 562, 5 N.E. 623, 625.

[24] The ruling in Helvering v. Butterworth, 1933, 290 U.S. 365, 54 S. Ct. 221, 78 L. Ed. 365, does not determine the question before us. There the Court was considering the question whether an annual income payable to a widow under a trust was taxable to her or to the trustees. The husband's will, after certain bequests, left the residue of his property to trustees with direction to pay the net income to the widow. She surrendered her rights under the state law, and, as the opinion states, "accepted under the will". 290 U.S. at page 368, 54 S. Ct. at page 222. The Court was construing Section 219 of the Revenue Act of 1924, c. 234, 43 Stat. 253, 275 (26 U.S.C. §960), which lay a tax upon "the income of estates or of any kind of property held in trust", allowing deductions for income distributed to beneficiaries.

Similar provisions were contained in the Act of 1926, c. 27, 44 Stat. 9, 32, 33, and the Act of 1928, c. 852, 45 Stat. 791, 838, §§161 and 162, 26 U.S.C. §§161, 162.

The trustees paid to the widow income during 1924 and 1925. The question before the Court was whether the amounts paid were taxable to her. The Court answered in the affirmative, holding that the widow was a *beneficiary*. The gist of the opinion is in this paragraph:

"Is a widow who accepts the provisions of her husband's will and receives part or all of the income from an established trust in lieu of her statutory rights a *beneficiary* within the ambit of the statute; We think she is. *It is unnecessary to discuss her rights or position under other circumstances.* We are dealing with a tax statute and seeking to determine the will of Congress. When she makes her election the widow decides to accept the benefits of the will with the accompanying rights and liabilities. In no proper sense does she purchase an annuity." Helvering v. Butterworth, supra, 396 U.S. at pages 369-370, 54 S. Ct. at page 222.

The case arose in Pennsylvania law which *is not* a community property state.

The dower cases, as is evident, are based upon the theory that the contingent estate of the wife becomes vested upon the death of the husband. California law gives to each spouse a "present, existing and equal" interest in com-

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Subsequent cases are of the view that, regardless of the language used, all that the case decided was that "the income (from a trust) was taxable to the beneficiary and not to the trustees". Stone v. White, 1937, 301 U.S. 532, 534, 57 S. Ct. 851, 852, 81 L. Ed. 1265; and see, Thomas v. Commissioner, 2 Cir., 1938, 100 F. 2d 408, 410; Harrison v. Commissioner, 7 Cir., 1941, 119 F. 2d 963, 968-969; Daggett v. Commissioner, 9 Cir., 1942, 128 F. 2d 568, 575; in re Roger's Estate (Stickney v. Commissioner), 2 Cir. 1944 143 F. 2d 695, 696; Burchenal v. Commissioner, 6 Cir., 1945, 150, F. 2d 482, 485; Dunlop v. Commissioner, 8 Cir., 1948, 165 F. 2d 284, 286-287.

But this is not the problem before us. The Court, in Helvering v. Butterworth, supra, wisely admonished that they were not discussing the widow's "rights or position under other circumstances". In the case before us, we are not determining whether the taxpayer was "a beneficiary". We consider another "circumstance", in which a taxpayer's "rights and position" under California community property are involved. We are determining whether, under California law, in surrendering her community property rights and taking under the will, she parted with value. Pertinently, this Court has said that for federal tax purposes, the character of property under a will is to be determined by state law:

"Whether the money here in question was received by the trustees as income or as corpus *depends upon the effect of the language of the will under the law of the jurisdiction in which the estate is administered.* * * * The government could not be bound by any determination of the parties at variance with the true facts. Here, however, the fact in question is whether the money is to be part of the corpus of the trust. The trustee has determined that it is not, and it appearing that this determination is justified by the terms of the will and the law of Hawaii, it should be given effect here." Commissioner v. Bishop Trust Co., 9 Cir., 1943, 136 F. 2d 390, 391.

So here, the question whether, in parting with her interest in the community property, the taxpayer parts with consideration is to be determined according to California law. See, Goold v. Commissioner, 9 Cir., 1950, 182 F. 2d 573, 575. Under it, the wife has a vested interest in one-half of the community property. *When she parts with it, she parts with value.*

munity property acquired since July 29, 1927.[25] During the lifetime of the husband, the entire community property is subject to his management and control.[26] Upon his death the property is released of his limited managerial and control powers and one-half of it, as the statute says, "belongs to the surviving spouse."[27] The other half is subject to the testamentary disposition of the decedent.

> "and in the absence thereof goes to the surviving spouse, subject to the provisions of sections 202 and 203 of this code."[28]

5. Only one of the sections referred to affects the wife by providing that the community property passed from the control of the husband "is subject to his debts and to administration and disposal."[29]

This Court, in interpreting California law, as changed by the Act of July 29, 1927, has held that the wife's interest being vested, her half never became a part of his estate:

> "The Tax Court appears to have assumed that, upon decedent's death, petitioner's half of the community property ceased to be hers and became a part of decedent's estate. The assumption is incorrect. Petitioner's half, like decedents's half, was subject to ad

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[25] California Civil Code, §161a.

[26] California Civil Code, §§172 and 172a.

[27] California Probate Code, §201. It "never belonged" to the decedent. In re Estate of King, 1942, 19 Cal. 2d 354, 363, 121 P. 2d 716; In re Estate of Kelley, supra, Note 17, 122 Cal. App 2d at page 43, 264 P. 2d at page 211.

[28] California Probate Code, §201.

[29] California Probate Code, §202.

ministration, but, unlike his half, her half never became a part of his estate."[30]

6. The principle was reaffirmed by this Court in a recent case.[31] Significantly, both in the cases arising under dower rights and those arising under the community property laws of California the election made by the widow after the death of the husband is considered *binding* on her if the language of the waiver is clear, as it was in the case before us.[32]

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[30] Bishop v. Commissioner, 9 Cir., 1945, 152 F. 2d 389, 391. In that case, this Court distinguished not only between cases arising under California community property law before and those arising since 1927, but also between cases arising under Washington and Texas community property laws because they contained *no* provisions similar to those obtaining in California since July 29, 1927. At page 391.

[31] Wells Fargo Bank & Union Trust Co. v. United States, 9 Cir. 1957, 245 F. 2d 524, 528. And see cases cited in Note 27.

[32] Muse v. Muse, supra, Note 9, and cases cited in Notes 15, 16 and 17. See also, In re Estate of Wyss, 1931, 112 Cal. App. 487, 297 P. 100. Cf. In re Estate of Brooks, 1946, 28 Cal. 2d 748, 752-755, 171 P. 2d 724. In the donative cases on which the Commissioner relies, we have either (a) joint wills (Commissioner v. McLean, 5 Cir., 1942, 127 F. 2d 942; McFarland v. Campbell, 5 Cir., 1954, 213 F. 2d 855, *both arising under Texas law*), or (b) trust funds created for the benefit of members of a family other than the wife who had no vested interest in the property and contributed little or nothing to the trust fund (Lehman v. Commissioner, 2 Cir., 1950, 109 F. 2d 99, *arising under New York law*) and in which a transfer of property in trust by decedent's brother which was paid for by decedent was held to be a transfer by the decedent and part of his taxable estate; Giannini v. Commissioner, 9 Cir., 1945, 148 F. 2d 285, *arising under California law*, in which this Court held that because the largest part of the consideration was contributed by the parents, the transfer was a gift). As appears from the foregoing discussion, in the case before us, the waiver of the wife's right to the community property was the transfer by her of a vested interest as consideration for the life estate and specific gift under the trust. So the reasoning of the donative cases does not apply. The fact stressed by the Commissioner that the taxpayer contended before the Tax Court that the transaction "was not a gift" under §1002 of the Internal Revenue Code of 1939 (26 U.S.C., 1952 Ed.,

III.

The Events Which Led to Surrender.

7. Factually, the record shows that the decision to accept the legacy under the will in lieu of the community property which she surrendered to the trust chiefly for the benefit of her son was arrived at by the taxpayer after full consultation between her and the trustees. In the hearing before the Tax Court, she testified in substance:

Her husband was only forty-seven years of age at the time of his death, dying of a coronary thrombosis which was sudden and unexpected. He had been a builder and contractor for over twenty-five years. They had been married for twenty-seven years, residing in California during the entire period of marriage except four years. The property accumulated was community property. She did not own any separate property of any consequence before marriage and neither of them had acquired any property by gift or inheritance at the time of her husband's death. The home they occupied cost $62,500, on which they made repairs amounting to $30,000, the furnishings of the house having been appraised in 1950 on the replacement basis as $60,000. They also owned a home at Palm Springs, completely furnished. For the calendar year 1947, the net income for federal tax purposes was $479,422.99 and for the

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§1002) and that, although the decision went against her, she has not appealed the ruling, has no bearing upon the determination of the question before us. She is not estopped from taking the position she now takes before this Court that, whether it was a gift or not, it was a transfer for a valuable consideration. What is important from the taxpayer's standpoint is that, contrary to the ruling of the Commissioner, the Tax Court considered the surrender by her of her interest in the community property the acceptance of an offer for a valuable consideration, and assessed her liability on the basis of the difference between the value of what she surrendered and what she received under the will. It is this position which the taxpayer is defending before us and which we consider legally correct.

year 1948, $230,399. Their living expenses, including the taxes for the year 1948 — as shown by excerpts from the books — were $46,551.49.[33]

At the time of Siegel's death, the adopted son was five and one-half years of age.

Of the two persons named as co-trustees, one Ben Weingart was a close friend and associated in business with Siegel. The other, N. B. Allison, was also a close friend whom the taxpayer and Siegel had known since arriving in California in 1926. They were suggested as trustees with her because Siegel considered them the most capable men to administer his estate and to be trustees of the trust. Although she was named as one of the co-trustees, Siegel did not discuss with her the terms of his Will prior to his death. About two weeks after his death, Weingart and the attorney for the estate explained the Will to her. She understood that if she took her half of the community property, she received nothing under the Will.

The matter was also discussed with the other co-trustees and finally, on the advice of Weingart, she decided to take under the will, for by so doing, she would have the benefit of the advice of the co-trustees as to investment and the entire estate would be under one management instead of two.

She summed up her testimony by saying that she took under the will because she could not maintain her standard of living on the income from her half and did not wish to lose control of the other half.

These facts were, in the main, confirmed by Weingart, who was consulted by Siegel about the terms of the will. He also corroborated the taxpayer's statement that he advised her to take under the will.

[33] These figures as to income were stipulated to and the personal expenditures were verified by excerpts from the ledgers introduced as exhibits.

A good portion of the estate consists of the ownership of apartment properties.

In the light of this recital of facts, it is quite evident to us that the Tax Court's determination that there was a transfer, the consideration for which was the value of the community property interest that she surrendered taxable only to the amount of the excess of the value of her transfer over what she received, is not clearly erroneous.[34] Indeed, we believe that no contrary conclusion is warranted. And, as the foregoing discussion discloses, we are also of the view that the Tax Court applied the law correctly to the facts.[35]

The petition for review is denied and the order of the Tax Court affirmed.

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[34] 26 U.S.C., 1952 Ed., §1141(a); I.R.C., 1954, §7482(a), 26 U.S.C. §7482(a). And see cases cited in Note 4, supra; Rule 52(a), Federal Rules of Civil Procedure.

[35] And see, Chase National Bank v. C.I.R., 1955, 25 T.C. 617.